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APRIL 25TH–MAY 1ST 2009

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Politics this week

Apr 23rd 2009
From The Economist print edition

EPA

South Africans went to the polls in the fourth general election since the beginning of black-majority rule in 1994. There was no doubt that the African National Congress party would win the most votes; early results showed the opposition Democratic Alliance doing well. Final results were expected after *The Economist* went to press. See article

An internal **Israeli** army investigation concluded that, despite a small number of errors, the army kept within the bounds of international law during the assault on the Gaza Strip three months ago. The verdict was immediately challenged by human-rights groups; at the time Israel was widely criticised for its heavy-handed tactics and "disproportionate" use of force.

At a UN conference on racism in Geneva, Iran's president, **Mahmoud Ahmadinejad**, delivered a tirade against Israel and the Western countries that helped to establish it. More than 20 European representatives walked out of the conference in protest. See article

About 40 people were killed in clashes between local residents and gang members of a criminal sect called the Mungiki in central **Kenya**.

Extracting confessions

Barack Obama visited the CIA's headquarters after authorising the release of classified memos on "**enhanced interrogation techniques**", such as waterboarding, used against al-Qaeda suspects. Civil-liberties groups said he should have gone further and ordered the prosecution of officials who authorised torture. Michael Hayden, George Bush's last CIA director, criticised the decision, arguing that terrorists could now train to withstand interrogation. Dick Cheney, the former vice-president, wanted the release of memos showing how effective the techniques had been in protecting lives. See article

In another sharp turnaround from the Bush era, America's Environmental Protection Agency ruled that **carbon dioxide** and five other greenhouse gases were pollutants that posed a threat to public health, delighting greens and disappointing some business groups, which gave warning of the cost of further regulation. Scientists at the EPA have long favoured such a ruling, which did not contain any specifics about reducing emissions of the pollutants. See article

The **Department of the Interior** declined to appeal against a judge's reversal of a policy that allowed people to carry loaded guns in national parks and wildlife refuges. The policy came into force in the dying days of the Bush presidency.

Mr Obama held his first cabinet meeting and called for his departments to find $100m in **savings** to "set the tone". The cuts represent 0.003% of the $3.5 trillion federal budget.

To the bitter end

Tens of thousands of Tamil civilians fled the last remaining patch of **Sri Lanka** controlled by the rebel Liberation Tigers of Tamil Eelam. Some told harrowing tales of their confinement for weeks under heavy artillery fire. The army, having breached the Tigers' defences, said its final victory in a 26-year war was close at hand. The whereabouts of the Tigers' leader, Velupillai Prabhakaran, remained uncertain. See article

North and South Korea held their first bilateral meeting for more than a year, at the joint industrial zone of Kaesong. It lasted just 22 minutes before breaking up with nothing agreed. North Korea

subsequently accused the South of moving a border marker. See article

India held the second of five rounds of voting in its month-long general election. Before the poll, Maoist rebels briefly seized a train carrying several hundred people in the state of Jharkhand.

Reuters

Tajikistan finalised an agreement with the United States allowing the transit of non-military supplies for forces fighting in Afghanistan. The agreement follows the decision by Kyrgyzstan to close the only American airbase in Central Asia.

A new leaf

At a 34-country **Summit of the Americas** in Trinidad, Barack Obama called for a "new partnership" between the United States and Latin America. Venezuela's Hugo Chávez proffered friendship and offered to restore his ambassador to Washington. But several Latin American countries expressed annoyance that the final summit communiqué did not call on the United States to drop its economic embargo against Cuba. See article

Fidel Castro wrote that Mr Obama had misinterpreted comments by his brother, Raúl Castro, Cuba's president, that **Cuba** was prepared to discuss "everything" with the United States. He rejected Mr Obama's call for Cuba to release political prisoners and scrap a 10% tax on remittances from Cuban-Americans.

Bolivia's government faced questions over its claim that an Irishman, a Hungarian-Bolivian and another man killed by police in a hotel in Santa Cruz were plotting to murder the president, Evo Morales. The Irish and Hungarian governments said that they doubted the official version.

Manuel Rosales, who lost to Hugo Chávez in **Venezuela's** presidential election of 2006, sought political asylum in Peru after being charged with corruption. He says the charges against him are politically inspired.

A "very big" embarrassment

British police released 11 Pakistanis and one Briton whom they had arrested two weeks ago in a counter-terrorism raid. Despite initially describing the alleged plot as "very, very big", the police failed to find enough evidence to bring charges. The government plans to deport the 11 Pakistanis anyway.

In the **British budget**, the government said that the economy would shrink by 3.5% in 2009/10, the worst year since 1945. The chancellor, Alistair Darling, raised the top income-tax rate to 50% and also increased duties on fuel, alcohol and tobacco. He forecast that public debt would double to almost 80% of GDP by 2013/14. See article

Getty Images

A court in **Russia** unexpectedly ordered the release from prison of Svetlana Bakhmina, a lawyer who worked for the jailed tycoon Mikhail Khodorkovsky. She has recently had a baby. He pleaded not guilty in his second trial on charges of embezzlement.

A parliamentary election in the Turkish-recognised republic of **northern Cyprus** was won by hard-line nationalists. The result may undermine reunification talks being conducted by the Greek-Cypriot and Turkish-Cypriot leaders. See article

Business this week

Apr 23rd 2009
From The Economist print edition

A moribund deal market showed signs of life. **Oracle** unveiled an agreed $7.4 billion offer for **Sun Microsystems**, a fellow technology titan, after discussions between Sun and IBM had foundered. The deal will give Oracle control of Java and Solaris, two prized software programs. IBM licked its wounds with first-quarter profits that beat expectations. See article

PepsiCo shook up the fizzy-drinks industry by offering $6 billion in cash and shares to take full ownership of its two biggest bottlers. Tighter control of its distribution system will help PepsiCo to ship products to big retailers more efficiently.

GlaxoSmithKline (GSK), a drugs giant, agreed on a $3.6 billion deal to buy Stiefel Laboratories, a dermatology firm. The purchase is part of a strategy to reduce GSK's reliance on blockbuster drugs by focusing more on consumer health-care products.

Shares fell sharply in **Roche**, a Swiss drugs firm, when it announced disappointing clinical-trial results for Avastin, a potential cancer treatment.

Honey, I shrank the bank

The slimming of **UBS** continued. The battered Swiss bank sold Pactual, a Brazilian investment bank, back to the company's founders for $2.5 billion, the same price it paid for the business in 2006. Profits at **Credit Suisse,** UBS's local rival, exceeded expectations.

More **American banks** reported first-quarter earnings. Bank of America unveiled a $4.2 billion net profit, thanks in part to better performance from Merrill Lynch, a much-maligned acquisition. Before dividend payments to preferred shareholders, Citigroup posted its first profit in six quarters. Wells Fargo confirmed a surge in earnings buoyed by a wave of mortgage refinancing. But Morgan Stanley posted a worse-than-expected loss of $177m.

Japan's second-largest bank, **Mizuho**, said it would post much worse than expected annual losses of about 580 billion yen ($5.9 billion), after suffering sharp falls in the value of its shareholdings and higher loan losses.

In further evidence of an **advertising slowdown**, the publisher of the *New York Times* and the *Boston Globe* fell steeply into the red in the first quarter. Falling ad sales also hit Yahoo!, an internet firm, which posted a 78% year-on-year fall in quarterly profits.

Hopes dived that **telecoms firms** would survive the downturn unscathed, as Deutsche Telekom issued a profits warning. AT&T lightened the mood by reporting better-than-expected first-quarter results, helped by cost cuts.

Apple announced a 15% rise in quarterly profits to $1.21 billion, on strong sales of its iPhone.

Hurrah! It's a loss

Two American **airlines** reported better-than-expected first-quarter losses. Delta Air Lines posted a net loss of $794m, and United Airlines one of $382m.

After creditors of **Chrysler**, America's third-largest car company, rejected government requests to slash the company's secured debt by 85%, the Treasury reportedly proposed cutting it by 78% and giving the creditors a 5% equity stake. Chrysler is trying to seal an alliance with Fiat, an Italian carmaker, before a government-imposed deadline of April 30th. See article

Hong Kong's appeal court blocked plans by **PCCW**, a telecoms operator, to buy out its shareholders. The court upheld objections by the territory's stockmarket regulator that blocks of PCCW shares had been handed out to friendly investors to ensure the plans were endorsed. See article

Hilton Hotels said it was suspending the development of Denizen, a new hotel brand, following allegations (which it denies) of **corporate espionage** made by Starwood, a rival. Federal authorities are investigating Starwood's claims that Hilton used confidential information smuggled out by former employees.

The IMF raised its estimate of the amount of red ink that financial institutions will spill as a result of the crisis. The fund thinks **total write-downs** will hit a staggering $4.1 trillion, fuelling fears that banks will need lots more capital to survive. The fund also revised its economic forecasts. It expects the world economy to shrink by 1.3% this year, compared with a prediction of 0.5% growth in January.

Grüne shoots?

The ZEW index of **economic sentiment** in Germany posted its first positive reading since the summer of 2007, boosting hopes that the worst is over. Sceptics pointed out that ZEW's index of current conditions continued to slump.

The threat of **deflation** remains. German producer prices fell more quickly than expected in March. And the retail-price index in Britain fell by 0.4% year on year in March, its first drop since 1960.

KAL's cartoon

Apr 23rd 2009
From The Economist print edition

Illustration by KAL

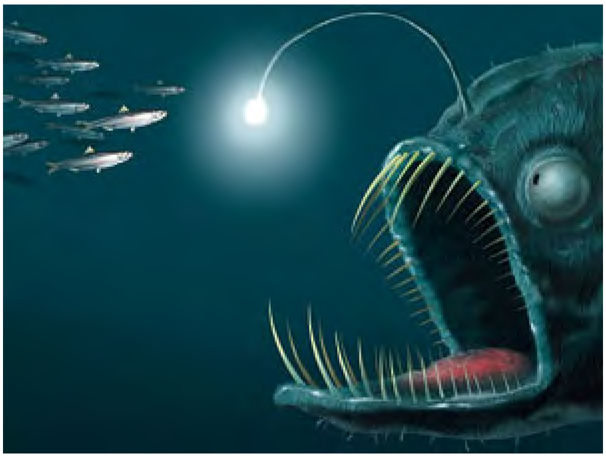
The world economy

A glimmer of hope?

Apr 23rd 2009
From The Economist print edition

The worst thing for the world economy would be to assume the worst is over

Illustration by Jon Berkeley



THE rays are diffuse, but the specks of light are unmistakable. Share prices are up sharply. Even after slipping early this week, two-thirds of the 42 stockmarkets that *The Economist* tracks have risen in the past six weeks by more than 20%. Different economic indicators from different parts of the world have brightened. China's economy is picking up. The slump in global manufacturing seems to be easing. Property markets in America and Britain are showing signs of life, as mortgage rates fall and homes become more affordable. Confidence is growing. A widely tracked index of investor sentiment in Germany has turned positive for the first time in almost two years.

All this is welcome—not least because the slump has been made so much worse by panic and despair. When the financial system was on the brink of collapse in September, investors shunned all but the safest assets, consumers stopped spending and firms shut down. That plunge into the depths could be succeeded by a virtuous cycle, where the wheels of finance turn again, cheerier consumers open their wallets and ambitious firms turn from hoarding cash to pursuing profits.

But, welcome as it is, optimism contains two traps, one obvious, the other more subtle. The obvious trap is that confidence proves misplaced—that the glimmers of hope are misinterpreted as the beginnings of a strong recovery when all they really show is that the rate of decline is slowing. The subtler trap, particularly for politicians, is that confidence and better news create ruinous complacency. Optimism is one thing, but hubris that the world economy is returning to normal could hinder recovery and block policies to protect against a further plunge into the depths.

Luminous indicators

Begin with those glimmers. It is easy to read too much into the gain in share prices. Stockmarkets usually rally before economies improve, because investors spy the promise of fatter profits before the statisticians document a turnaround. But plenty of rallies fizzle into nothing. Between 1929 and 1932, the Dow Jones Industrial Average soared by more than 20% four times, only to fall back below its previous lows. Today's crisis has seen five separate rallies in which share prices rose more than 10% only to subside again.

The economic statistics are hard to interpret, too. The past six months have seen several slumps, each with a different trajectory. The plunge in manufacturing is in part the result of a huge global inventory adjustment. With unsold goods piling up and finance hard to come by, firms around the world have

slashed production even faster than demand has fallen. Once firms have run down their stocks they will start making things again and the manufacturing recession will be past its worst.

Even if that moment is at hand, two other slumps are likely to poison the economy for much longer. The most important is the banking crisis and the purge of debt in the bubble economies, especially America and Britain. Demand has plummeted as tighter credit and sinking asset prices have exposed consumers' excessive borrowing and scared them into saving more. History suggests that such balance-sheet recessions are long and that the recoveries which eventually follow them are feeble.

The second slump is in the emerging world, where many economies have been hit by the sudden fall in private cross-border capital flows. Emerging economies, which imported capital worth 5% of their GDP in 2007, now face a world where cautious investors keep their money at home. According to the IMF, banks, firms and governments in the emerging world have some $1.8 trillion-worth of borrowing to roll over this year, much of that in central and eastern Europe. Even if emerging markets escape a full-blown debt crisis, investors' confidence is unlikely to recover for years.

These crises sent the world economy into a decline that, on several measures, has been steeper than the onset of the Depression. The IMF's latest *World Economic Outlook* expects global output to shrink by 1.3% this year, its first fall in 60 years. But the collapse has been countered by the most ambitious policy response in history. Central banks have pumped out trillions of dollars of liquidity and, in rising numbers, have resorted to an increasingly exotic arsenal of "unconventional" firepower to ease credit markets and loosen monetary conditions even as policy rates approach zero. Governments have battled to prop up their banks, committing trillions of dollars in the process. The IMF has new money. Every big rich country has bolstered demand with fiscal stimulus (and so have many emerging ones). The rich world's budget deficits will, on average, reach almost 9% of GDP, six times higher than before the crisis hit.

The Depression showed how damaging it can be if governments don't step in when the rest of the economy seizes up. Yet action on the current scale has never been tried before and nobody knows when it will have an effect—let alone how much difference it will make. Whatever the impact, it would be a mistake to confuse the twitches of an economy on life-support with a lasting recovery. A real recovery depends on government demand being supplanted by sustainable sources of private spending. And here the news is almost uniformly grim.

Searching for new demand

Take the country many are pinning their hopes on: America. The adjustment in the housing market began earlier there than anywhere else. Prices peaked almost three years ago, and are now down by 30%. Manufacturing production has been falling at an annualised rate of more than 20% for the past three months. And the government's offsetting policy offensive has been the rich world's boldest.

As the inventory adjustment ends and the stimuli kick in, America's slump is sure to ease. Cushioned by the government, the economy may even begin to grow again before too long. But it is hard to see the ingredients for a recovery that is robust enough to stop unemployment rising. Weakness abroad will crimp exports. America's banks are propped up with public capital, but their balance-sheets are clogged with toxic assets. Consumer spending and firms' investment will be dragged lower by the need to pay back debt and restore savings. This will be a long slog. Private-sector leverage, which rose by 70% of GDP between 2000 and 2008, has barely begun to unwind. At 4%, the household savings rate has jumped sharply from its low of near zero, but it is still far below its post-war average of 7%. Higher unemployment and rising bankruptcies could easily cause a vicious new downward lurch.

In Britain, given the size of its finance industry, housing boom and consumer debt, the balance-sheet adjustment will, if anything, be greater. The weaker pound will buoy exports, but fragile public finances suggest that Britain has much less scope to use government spending to cushion the private sector than America does—as this week's flawed budget made painfully clear (see article).

The outlook should in theory be brighter for Germany and Japan. Both have seen output slump faster than in other rich countries because of the collapse in trade and manufacturing, but neither has the huge private borrowing of the sort that haunts the Anglo-Saxon world. Once inventories have adjusted, recovery should come quickly. In practice, though, that seems unlikely, especially in Germany. As the output slump sends Germany's jobless rate towards double-digits, it is hard to see consumers going on a spending spree. Nor has the government shown much appetite for boosting demand. Germany's fiscal stimulus, although large by European standards, falls well short of what it could afford. Worse, the

country's banks are still in trouble. Germans did not behave recklessly, but their banks did—along with many others in continental Europe. New figures from the IMF suggest that European banks face some $1.1 trillion in losses, hardly any of which have yet been recognised (see article). This week's German plan to set up several bad banks was no more than a down payment on the restructuring ahead.

Japan has acted more boldly. Its latest package of tax cuts and government spending, unveiled in early April, will provide the biggest fiscal boost, relative to GDP, of any rich country this year. Its economy is likely to perk up, temporarily at least. But its public-debt stock is approaching 200% of GDP, so Japan has scant room for more fiscal stimulus. With export markets weak, demand will soon need to be privately generated at home. But the past two decades offer little evidence that Japan can make that shift.

For the time being, the brightest light glows in China, where a huge inventory adjustment has exaggerated the impact of falling foreign demand, and where the government has the cash and determination to prop up domestic spending. China's stimulus is already bearing fruit. Loans are soaring and infrastructure investment is growing smartly. The IMF's latest forecast, that China's economy will grow by 6.5% this year, may prove conservative. Yet even China has its difficulties. Perhaps three-quarters of the growth will come from government demand, particularly infrastructure spending.

Not much to glow about

Add all this up and the case for optimism fades quickly. The worst is over only in the narrowest sense that the pace of global decline has peaked. Thanks to massive—and unsustainable—fiscal and monetary transfusions, output will eventually stabilise. But in many ways, darker days lie ahead. Despite the scale of the slump, no conventional recovery is in sight. Growth, when it comes, will be too feeble to stop unemployment rising and idle capacity swelling. And for years most of the world's economies will depend on their governments.

Consider what that means. Much of the rich world will see jobless rates that reach double-digits, and then stay there. Deflation—a devastating disease in debt-laden economies—could set in as record economic slack pushes down prices and wages, particularly since headline inflation has already plunged thanks to sinking fuel costs. Public debt will soar because of weak growth, prolonged stimulus spending and the growing costs of cleaning up the financial mess. The OECD's member countries began the crisis with debt stocks, on average, at 75% of GDP; by 2010 they will reach 100%. One analysis suggests persistent weakness could push the biggest economies' debt ratios to 140% by 2014. Continuing joblessness, years of weak investment and higher public-debt burdens, in turn, will dent economies' underlying potential. Although there is no sign that the world economy will return to its trend rate of growth any time soon, it is already clear that this speed limit will be lower than before the crisis hit.

Start preparing for the next decade

Welcome to an era of diminished expectations and continuing dangers; a world where policymakers must steer between the imminent threat of deflation while countering investors' (reasonable) fears that swelling public debts and massive monetary easing could eventually lead to high inflation; an uncharted world where government borrowing reaches a scale not seen since the second world war, when capital controls ensured that savings stayed at home.

How to cope with these dangers? Certainly not by clutching at scraps of better news. That risks leading to less action right now. Warding off deflation, for instance, will demand more unconventional steps from more central banks for longer than many now seem to foresee. Laggards, such as the European Central Bank, do themselves and the world no favours by holding back. Nor should governments immediately seek to take back the fiscal stimulus. Prolonged economic weakness does far greater damage to public finances than temporary fiscal activism. Remember how Japan snuffed out its recovery in the 1990s by rushing to raise taxes.

Japan also put off bank reform. Countries facing big balance-sheet adjustments should heed that lesson and nudge reform along, in particular by doing more to clean up and restructure the banks. Countries with surpluses must encourage private spending at home more vigorously. China's leaders are still doing too little to boost private citizens' income and their spending by fostering reforms, from widening health-care coverage to forcing state-owned firms to pay higher dividends.

At the same time policymakers must give themselves room to change course in the future. Central banks need to lay out the rules that will govern their exit from exotic forms of policy easing (see article). That may require new tools: the Federal Reserve would gain from being able to issue bonds that could mop up liquidity. All governments, especially those with the ropiest public finances, should think boldly about how to lower their debt ratios in the medium term—in ways that do not choke off nascent private demand. Rather than pushing up tax rates, they should think about raising retirement ages, reining in health costs and broadening the tax base.

This weekend many of the world’s finance ministers and central bankers will meet in Washington, DC, for the spring meetings of the IMF and World Bank. Amid rising confidence, they will be tempted to pat themselves on the back. There is no time for that. The worst global slump since the Depression is far from finished. There is work to do.

Politics and the British budget

Desperate measures

Apr 23rd 2009
From The Economist print edition

Gordon Brown's budget is a dishonest piece of pre-election politicking

Photo by David Levene

THE wheel of fortune turns swiftly in politics. Gordon Brown pulled off the G20 meeting in London on April 2nd, emerging with a plausible aura of global statesmanship. After a handful of Labour sleaze stories and a misguided statement on YouTube, the prime minister looked more like Richard Nixon: shifty, angry and with a list of enemies to smear. And that was before a downright dishonest budget on April 22nd.

The budget was a crucial one, for two reasons. First, Mr Brown is running out of time—he has to hold an election by June 2010—and Britain seems increasingly fed up with him. The public regards his party with distaste (see article). That's partly because a dozen years in power tends to tarnish: when the home secretary's husband charges the taxpayer for the porn he watches, one gets an inkling that a government's time is up. But it's also because of Mr Brown's character. His strength, which the G20 meeting displayed, is dour pragmatism. Too often, though, he resorts to tribal politics, in a way that seems both scheming and incompetent.

Second, the budget marks the government's attempts to deal with the fiscal consequences of the worst slowdown since the second world war. Mr Brown is partly to blame for this mess, but crisis management should have played to his strengths; instead, it revealed his worst side.

The eye-watering figures

The budget presented a statistical snapshot of the gruesome shape in which Britain now finds itself (see article). Gone are the days when quarters of growth succeeded each other nose to tail and national debt was limited by a fiscal rule to 40% of GDP. Even the Treasury now expects the economy to contract by 3.5% in the financial year beginning this April. That, bad as it seems, is better than many countries (Japan or Germany, for example) can look forward to, as our accompanying leader makes clear. Sterling's fall and Britain's relatively low dependence on manufacturing exports are the main reasons.

Britain's public finances, however, are on some measures the worst of any rich country. It is likely to have a bigger deficit in 2010, as a percentage of GDP, than even the likes of Italy. With the financial heart shot out of the economy, tax revenues have fallen dramatically just as social spending has increased. That is unavoidable; but the government's heavy borrowing, even before recession hit, was not. Now Mr Brown needs to tap the markets for £175 billion ($254 billion) in the current fiscal year and the same the year after. In last year's budget, public net debt was expected to be 39% of GDP this year; now it is put at 59%, and likely to increase to 79% by 2013-14. This outcome would push Britain only to

the middle of the rich-country pack. But the rapid increase in borrowing is eye-watering.

Given these constraints, the budget was never going to be pretty. Alistair Darling, Mr Brown's chancellor of the exchequer, looked a harried man as he made what is usually a grip-and-grin sprint to the House of Commons, brandishing the budget in Gladstone's red box. He had to reassure potential creditors that the government had a plan for tightening fiscal policy in the medium term, while convincing voters that any such austerity would not wallop them personally or at once. A hard job, not least because he could not blame his predecessor for the mess; but one in which candour, above all, was necessary. Instead came two all-too-political sleights of hand: a string of over-optimistic economic assumptions and the misleading message that soaking the rich could absolve the other 98% of the population from personal sacrifice.

The fiscal plans are like one of those childish excuses that begin with a little exaggeration and morph into outright falsehood. The theoretical commitment to cut the growth of current spending to 0.7% a year from 2011-12 is to be implemented only after the election; it also relies a lot on the familiar hogwash of "efficiency savings". It would be unworldly to expect a government on the eve of an election to be explicit about its intended cuts, and the depths of a recession are not the place to wield the axe anyway. What is really galling is that, in order to make the deficit shrink, the Treasury assumes that the economy will start growing again at the end of this year and expand by 3.5% in 2011. This "trampoline recovery", as the Tories called it, is a far more optimistic view than either the IMF or most private-sector economists take. No prudent prime minister would have allowed it.

The second fiction is that squeezing the rich can absolve the rank and file from privation (other than dearer fuel, tobacco and drink). Mr Darling and Mr Brown propose raising the top rate of tax from 40% to 50% next year (they had already mooted a rise to 45% from 2011-12) on those with incomes over £150,000 and a couple of other bash-the-rich measures. This will irritate the 1-2% of taxpayers affected; but it will hardly solve the problem. That will require broader, more painful measures in the medium term: higher taxes for all, tougher spending cuts, or a bit of both.

Don't quit the centre

This must seem like clever politics to Mr Brown and his crew: folk have been inflamed by the greed and grubbiness of bailed-out bankers. In the short run, a bit of class war may work. But, like Nixon, Mr Brown is already struggling to escape the suspicion that he has a grudge against the world. And for every voter who likes the idea of soaking the rich, there may be several who remember that Labour pledged at the last election not to raise tax rates during the life of this parliament. In turning his back on the revolution in thinking that brought New Labour to power in 1997—that even though few Britons were very rich, many aspired to be—Mr Brown may be quitting the hard-won centre ground too soon. The entrepreneurial classes are now surely the Tories' for the taking.

April offered Mr Brown two shots at reviving his flagging premiership. The G20 went well. But by attempting to use the budget for political advantage rather than engaging the nation honestly in a slow, shared transformation, the prime minister has done neither himself nor his country any favours. The public is losing patience with him, and so is this newspaper.

The United States and Latin America

A new start in the Americas

Apr 23rd 2009
From The Economist print edition

Barack Obama has dangled a carrot for Cuba and Venezuela. Time for Brazil and others to show a bit of stick

AP

ANTI-AMERICANISM was invented in Latin America as the expanding United States first swallowed a chunk of Mexico and then turned the Caribbean into an American lake, arousing nationalist resentment along the way. There have since been other, more co-operative strands in inter-American relations. But George Bush reminded many Latin Americans that what they like least about their northern neighbours is an attitude of overbearing arrogance. He thus offered an easy target for those, such as Venezuela's Hugo Chávez, who like to blame their countries' problems on a foreign scapegoat.

Barack Obama seems determined to disarm such critics. On his first visit to the region, which included a 34-country Summit of the Americas in Trinidad from April 17th to 19th, he charmed his fellow leaders by talking of equal partnership. But will Mr Obama be more successful with the neighbours than Mr Bush, who was accused of allowing his country's influence in Latin America to decay?

Mr Obama wants to change some of Mr Bush's policies towards the region while keeping others. He has offered Mexico's president, Felipe Calderón, support in his fight against drug gangs. Bravely, he wants to resurrect immigration reform, which matters to Mexico and Central America; less bravely, he has little appetite for battling to reinstate a lapsed ban on semi-automatic "assault weapons" in the United States, many of which find their way to drug gangs south of the border. Like his predecessor, Mr Obama has sensibly recognised Brazil's new stature as South America's leading power.

Engaging Cuba

The most obvious change has come on Cuba. Shortly before the summit, the administration said it would scrap Mr Bush's curbs on visits and remittances to the island by Cuban-Americans, and allow American telecoms companies to do business there. This was welcome. As Mr Obama says, the American economic embargo "hasn't worked the way we wanted it to: the Cuban people aren't free". But that is an argument for scrapping it, rather than merely tinkering. *The Economist* has long believed that the embargo is unfair (it hurts Cubans rather than their government), illogical (America has normal relations with other communist countries such as China and Vietnam) and counterproductive (it gives the Castro brothers a pretext for tyranny). Many Americans have come round to that view. Congress may now start to dismantle the embargo. It is odd indeed that one group of Americans can now travel freely to Cuba while the majority cannot.

Before doing more Mr Obama wants Cuba to reciprocate by, for example, freeing political prisoners. But a more rational American policy should not be held hostage to an immediate response. It is by changing Cuban society, and by offering an alternative to dependence on Mr Chávez's free oil, that American economic engagement might nudge Cuba to reform.

Mr Obama was polite to Mr Chávez in Trinidad. He is right when he says that Venezuela poses no security threat to the United States. But as Venezuela's economy weakens, its president is cracking down on his opponents. This month Mr Chávez crudely disempowered the newly elected opposition mayor of Caracas, the capital. Mr Obama seems to agree with Mr Bush that public criticism of Mr Chávez is counterproductive. But it is in the interest of all the people of the Americas that the region's relatively recent embrace of democracy and human rights be sustained. Mr Obama has made a promising start in his quest to persuade Latin Americans that the United States is "a force for good" in the region. Vain though the hope may be, it would be nice if Brazil and others responded by denouncing those in Havana and Caracas who hide behind anti-Americanism as a pretext for their own authoritarianism.

Sri Lanka's war

To the bitter end

Apr 23rd 2009
From The Economist print edition

The Sri Lankan army could turn triumph into disaster unless it shows restraint

Reuters

CORNERED, and on the brink of an historic defeat, the Liberation Tigers of Tamil Eelam are as cruel and brutal as ever. As *The Economist* went to press, tens of thousands of civilians, human shields for Tiger fighters, had fled the last patch of Sri Lanka under LTTE control, a tiny beach-side hellhole grotesquely misnamed a “no-fire zone”. But the Tigers’ downfall will not resolve the ethnic conflict that has underpinned their 26-year war. That will require a political settlement in which the government of Sri Lanka seems to have little interest.

The Tigers’ outrageous tactics should come as no surprise. In the past, they have resorted to virtually every despicable technique in the terrorists’ manual: suicide-bombing, assassination, extortion, the press-ganging of children. They pose as protectors of Sri Lanka’s Tamil minority, and as its sole representative in the struggle for a homeland (“Eelam”) in the north and east of the island. Yet for weeks the Tigers have held hostage perhaps 150,000-200,000 Tamil civilians, subject to daily shelling and gunfire. Their bloodthirsty leader, Velupillai Prabhakaran, may be preparing a final showdown.

For the Sri Lankan government and its army, this poses a dilemma. With a long-sought victory apparently in their grasp, they are unlikely to heed appeals for restraint. But the government must try to save civilian lives. Not only does it say that is why it is fighting. It is also an imperative if there is to be any hope of reconciliation with the Tamil minority.

The army accuses the Tigers of bombing the no-fire zone themselves, to enlist international support in calls for a ceasefire. Such callousness would not be beyond Mr Prabhakaran. But of 3m Tamils in Sri Lanka and a further 1m in the diaspora, very few believe the government. It has, after all, kept reporters and most aid agencies away from the battlefront. At times, it has refused to allow in medicines. If the safety of civilians has been its main concern, it has made a poor fist of it. The United Nations estimates 4,500 have been killed this year.

Over the years, abusive behaviour by the Sri Lankan army and the refusal of the government to offer genuine political concessions to Tamil demands have done much to sustain the dreadful Tigers. Even now, they have many sympathisers among the thousands who have staged protests in Western capitals against the army’s campaign. Many Tamils in Sri Lanka itself still see the government, not the Tigers, as their enemy.

No eastern promise

Government spokesmen habitually present the struggle with the Tigers as simply the eradication of terrorists, who are as loathed by ordinary Tamils as they are by Sinhalese. But the government also promises a political settlement, in which power is devolved and something is done to meet Tamil aspirations. Alarmingly, however, they often point to Sri Lanka's Eastern Province, which fell to the army in 2007, as a model of devolution and democracy. Elections were held a year ago to a provincial council, won by a party representing a faction that split from the Tigers in 2004. To most Tamils, however, the east does not appear a beacon of hope. Power has not been devolved to the council, and the security forces and their local allies behave with heavy-handed unaccountability. Tamils, by most independent accounts, still feel alienated.

Those fleeing the Tigers face internment in bleak conditions and often a desperate search for family members. Fearing the Tigers will regroup among displaced civilians and continue their terrorism, it is perhaps natural that the government should keep a close eye on them. But that will make it even harder to convince Tamils that the war against the Tigers is on behalf of all Sri Lankans, not just the Sinhalese majority.

Cyberwar

Battle is joined

Apr 23rd 2009
From The Economist print edition

A behind-the-scenes conflict appears to be under way—but not the sort you might think

Illustration by Claudio Munoz

IT IS the new frontier for military and intelligence activity: cyberspace. For years military experts and computer scientists have speculated about the possibility of a nation's infrastructure being attacked using computers, rather than bombs. There have been dark warnings of the danger of a "digital Pearl Harbour"—an unexpected strike in which digital attackers shut down America's electrical grid or air-traffic control systems, or hack into nuclear-power stations and cause them to overheat. In recent years such concerns have been heightened by the first real examples of large-scale cyber-attacks—on Estonia in 2007 and Georgia in 2008. In each case, government websites were brought down by a deluge of traffic, apparently from Russia. The actual damage done was minimal, but it has all added to the sense of urgency, in America in particular, about the need to protect critical infrastructure from such an attack.

In the past few weeks there have been alarming reports that America's systems have already been infiltrated. On April 8th the *Wall Street Journal* quoted "current and former national-security officials" who warned that "cyberspies" from China, Russia and elsewhere had broken into the systems that control America's electrical grid and had installed software that could be used to disrupt it. And on April 21st the newspaper said foreign hackers had penetrated computers containing data about the F-35 Joint Strike Fighter. Does this mean America is suddenly under attack, and that war has broken out in cyberspace?

It is difficult to believe that America, Russia and China are not all probing each other's computer systems, and the picture is further complicated by the involvement of unofficial groups, such as those thought to have attacked Estonia and Georgia (whether or not they are backed by governments is a murky matter). But the most likely explanation for the sudden spate of scare stories is rather more mundane: a turf war between American government agencies over who should oversee the nation's cyber-security. In one corner is the Department of Homeland Security, which operates the National Cyber Security Centre (NCSC), a body set up to co-ordinate America's various cyber-security efforts. In the other corner is the National Security Agency (NSA), which thinks it ought to be in charge. At stake are tens of billions of dollars in funding promised for a multi-year cyber-security initiative.

In February Barack Obama launched a review of America's cyber-security efforts. The findings are expected to influence how funds are allocated and the relative balance of power between the various agencies. Frantic jockeying for position may explain the recent scare stories, and their curious lack of detail.

Information warfare

The outcome of this behind-the-scenes struggle may well be a compromise. The official in charge of the review has talked of establishing a cyber-security office within the White House to co-ordinate the efforts of different agencies. And at a security conference in San Francisco this week the director of the NSA insisted that his agency did not want sole responsibility for cyber-security, but wanted to work with other agencies.

So do not be surprised if cyber-security miraculously seems to improve once Mr Obama decides how to divide up the money and the power. But that is no excuse for frightening everybody, nor for making an already murky subject much murkier. The agencies involved need to focus on improving security, not playing politics and spreading scare stories.

On Mexico's drug wars, Conrad Black, religious defamation, unloved oligarchs, our new Asian column

Apr 23rd 2009
From The Economist print edition

Ammunition in the debate

SIR – Your article on the drug wars in Mexico claimed that half the guns seized by the Mexican police were "assault weapons" and that "nearly all" of those were bought in the United States ("Taking on the narcos, and their American guns", April 4th). However, Mexico doesn't trace all guns, and those traced are not picked at random. When Mexico seizes guns from criminals it sends to the United States those guns that it identifies as having come from the United States. This isn't a hard task as such guns are marked with a serial number and "Made in the USA". Only 17% of all guns were actually traced back to the United States.

Mexico is a virtual arms-bazaar, with AK47s from China, shoulder-fired rockets from Soviet-block manufacturers, and fragmentation grenades from South Korea. These weapons aren't sold in the United States. Americans can buy civilian versions of AK47s only—semi-automatic rifles that operate like deer-hunting rifles, not the guns used by armies around the world. Mexican drug gangs don't want the American "assault weapons" that "look like" military weapons; they want guns that are military weapons.

John Lott
Senior research scientist
University of Maryland
College Park, Maryland

Conrad Black responds

SIR – I have several comments on your article that compared Canada's criminal-justice system unfavourably with the system in the United States, and in which you made reference to me ("Too trusting", April 4th). You praise the United States' grand-jury and plea-bargain systems and lament that I was not charged in Canada "although some of the press baron's offences were committed there." America's constitutional guarantees of due process, the grand jury as an assurance against capricious prosecution, no seizure of property without just compensation, access to counsel, speedy justice, an impartial jury and reasonable bail have all been put to the shredder with the complicity of almost the entire legal, media and political communities.

Procedural rules are stacked against the defence, most judges are ex-prosecutors, and the prosecution has the last word, winning 90% of their cases. Sentencing is draconian and the United States now has more than six times as many confined people per head compared with countries such as Canada and Britain. The entire system is based on the plea bargain—the exchange of evidence for immunity or a reduced sentence—and is notoriously subject to abuse. I won 90% of my case and the rest is on appeal.

A Canadian court recently upheld my right to proceed with my libel suits against the sponsors of my prosecution in Chicago, and reserved the right for a Canadian court to take into account whether, for purposes of determining and quantifying libel, to set aside or discount the guilty verdicts.

Conrad Black
Coleman, Florida

Religious nonsense

SIR – I agree that freedom of speech "must include the right to 'defame' religions" ("The meaning of freedom", April 4th). The UN Human Rights Council, which adopted a resolution decrying religious

defamation as an affront to human dignity, is controlled mostly by countries that are among the most prolific violators of civil rights, including the right to speak one's mind.

The blasphemy document itself is remarkable in its scope and deliberate vagueness. Notorious civil-rights violators like Iran and Saudi Arabia will now be able to claim with some confidence that the UN is on their side when they clamp down on liberal-minded or secular Muslims. Western countries will also be happy to note that the council thinks the human right to free speech is not violated when they enforce their own, less draconian, blasphemy laws. The UN has firmly established itself as a body that is not even prepared to defend the basic principles enshrined in its Declaration of Human Rights.

Udo Schuklenk
Professor of philosophy
Queen's University
Kingston, Canada

The following letter appears online only

SIR – The right to examine and disagree with any institution, especially the church or state, benefits the object of inspection. The UN Human Rights Council's decision to forbid "defamation" of religion fails to recognise the benefits of scrutiny in evaluating the integrity of a religion.

Islam is strong enough to withstand criticism. If the countries that lobbied for the UN vote believe this, the resolution would not have passed.

Stephen Wong
Germantown, Maryland

Scapegoats

SIR – You are quite right to draw attention to the new trial of Mikhail Khodorkovsky ("A new Moscow show trial", April 4th). The proceedings are sure to hold a mirror to Russian society. However, I believe you are mistaken to think that Russian opinion is warming to the former oligarch. For the majority of Russians, Mr Khodorkovsky continues to personify the excesses of 1990s capitalism, when the dubious activities of the few exacerbated the misery of millions.

To understand the depth of such animosity look no further than the anger presently directed towards bankers such as Sir Fred Goodwin, Royal Bank of Scotland's former boss. Rightly or wrongly, such figures come to represent everything that was wrong with the former system and become focal points for popular fury. When an opportunity is found to enact retribution, the general public is liable to cast aside respect for due process or private property. Were Sir Fred to face an unjust and politicised trial, I fear that very few would rush to his defence.

James Brown
Aberdeen

A tree of Asian life

SIR – The Banyan column on Asia is a welcome addition to *The Economist* (April 11th). I look forward to reading his analysis, even if the region has been artificially cobbled together. For evidence, consider the column's eponym. "Banyan", as you note, is derived from the language of the Portuguese colonisers. Thus, Asia finds unity under a European word.

Christopher Schaefer
Philadelphia

SIR – I sense a deeper politics involved in choosing the name Banyan. Charlemagne and Bagehot would have been intimidated by Genghis Khan, and Lexington easily out-liberalled by Sri Vijaya, a Malay kingdom that dominated South-East Asian trade. Still, the Magna Carta was stamped in a muddy field, the first Swiss confederates met in another, the Chinese Communist Party's inaugural convention took place on a paddle boat, Indonesia's *pancasila* was first declared in Sukarno's washyard, and Thomas

Jefferson drafted America's Declaration of Independence in all sorts of similarly pitiable environments. Brick, mortar or steel cannot properly house the measure of *droits de l'homme*.

Tze Shiung Ng
Kuala Lumpur

SIR – The Bodhi tree isn't really a "banyan by another name". They are two unique species taxonomically (*Ficus religiosa* and *Ficus benghalensis*). Even those uninitiated in horticulture can tell the difference based on the respective shape of their leaves. Furthermore, I think that in India it was probably the traders and merchants from the *bania* caste who conducted business under the sprawling banyan trees that gave it its name, not the Portuguese.

Murali Reddy
Lake Hiawatha, New Jersey

SIR – It is refreshing to see a return to the image of the banyan tree as a place where people gather and learn. The Golkar party in Indonesia uses the banyan as its symbol, and it came to be resented as the overpowering tree under which nothing can grow. We haven't quite got over the association.

Ati Hadimadja
Jakarta

Economist.com BRIEFINGS

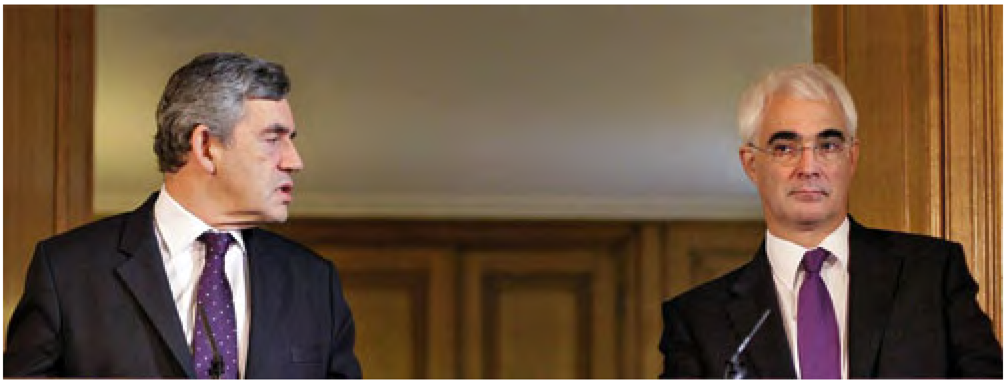
Britain after the budget

Hubris and nemesis

Apr 23rd 2009
From The Economist print edition

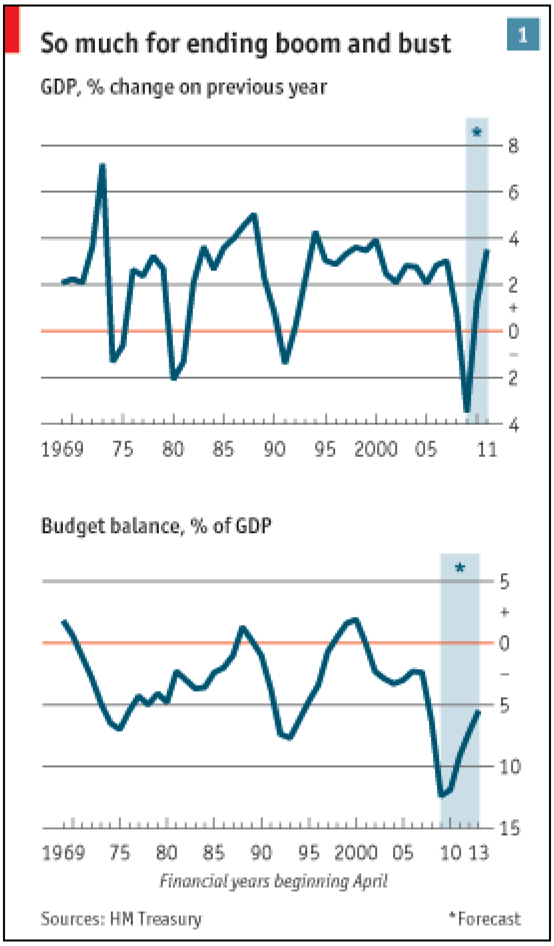
A shocking budget lays bare the fiscal cost of a savage downturn

AP



DURING his ten-year stint as chancellor of the exchequer, Gordon Brown used his budgets to make extravagant boasts about how brilliantly the economy was performing with him in charge. A sustained period of stable growth was supposedly the longest not just since quarterly GDP figures began in 1955 but for more than two centuries. Mr Brown was imprudent as well as immodest. In a string of over-optimistic budgetary forecasts, he brushed aside worries about a deteriorating fiscal position as public spending surged at his behest.

Alistair Darling, who took over at the Treasury when Mr Brown became prime minister in June 2007, must feel like a street-cleaner employed to clear up after the cavalry has gone by. The projections he presented this week in his second budget were the grisliest any post-war chancellor has had to make. They showed not only that the fall in national output in 2009 would be the biggest since 1945, but also that the budget deficit as a share of the economy, both this fiscal year and next, would be the largest since then (see chart 1). This year alone the government will be borrowing a breathtaking £175 billion ($254 billion), worth 12.4% of GDP.



So much for Mr Brown's earlier claims of unparalleled economic stability and fiscal prudence. Instead, Britons are facing a poorer future in which they pick up the tab for ballooning public debt. But if April 22nd was the cruellest day for the prime minister and the 12-year-old Labour government—not to mention a harsh reality-check for the British public—it also had a broader international relevance. Despite some sightings of green shoots, an early or robust global recovery remains unlikely. Yet even if the recession ends sooner than expected, the bills facing taxpayers around the world will still be massive.

Britain's sorry experience is a prime exhibit of what is to come as economies find themselves saddled with additional public debt. Scant comfort though this may be, the economy is no longer expected to be the worst-performing among its peer group of the Group of Seven industrial countries. That only makes the deterioration in Britain's public finances, which will show the biggest deficit in the G7 in 2010, all the more extraordinary.

From economic denial to confession

Only a year ago, Mr Darling's first budget struck a very different note from this week's sombre affair. Even though the global financial crisis was more than six months old and had already claimed Northern Rock as one of its first victims, the chancellor predicted that the economy would barely break its stride. Not content with issuing forecasts of continuing sturdy GDP growth together with sanguine projections for public borrowing, he asserted, on the strength of Treasury research, that Britain's economy would cope better than others because it had become particularly resilient to shocks.

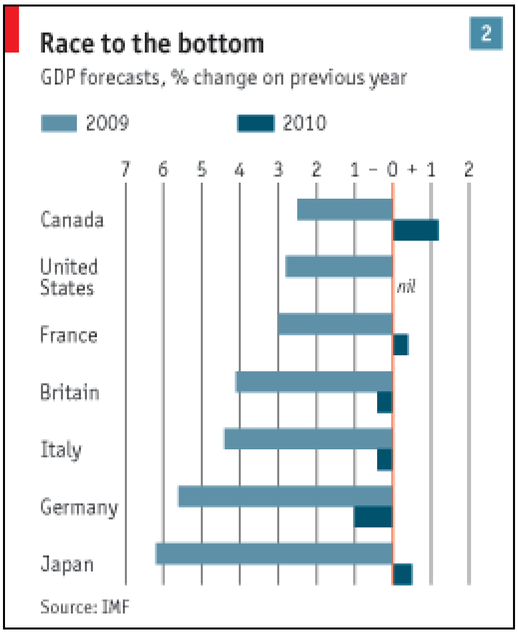
Even then such claims were implausible, the research outdated and irrelevant. Since the financial crisis broke in August 2007, the British economy had looked especially shaky rather than resilient. It was at Northern Rock, after all, that depositors lined up in the streets a month later to withdraw their money—the first run on a British bank since 1866. As pictures of those queues were beamed around the world, sterling started to slide.

International investors had good reason to take fright. Britain appeared vulnerable on three counts. First, the economy was exposed to the credit crisis through its own big banks and London's salience as an international financial centre. Second, British households had run up the biggest debt—relative to disposable income—in the G7 after a long borrowing boom. And third, the rise in British house prices

during the bubble years had been among the most extreme internationally.

Although the British economy seemed fated to be the world's fall-guy, it has not turned out that way. As global activity slid into the abyss in the final months of 2008, it became clear that other big economies—notably Japan and Germany—were falling farther. Although they might have avoided the spending and borrowing excesses of the Anglo-Saxon world, their export-driven economies were particularly exposed to the global downturn that followed last autumn's financial panic after Lehman Brothers went bust.

Three months ago, the International Monetary Fund (IMF) predicted that Britain would see a 2.8% decline in GDP this year, the most severe among the G7 economies. Forecasts published by the IMF on April 22nd revised the fall in British national output to an even graver 4.1%, worse than Mr Darling's new projection of 3.5%. But even that bigger contraction was surpassed by new figures for three other countries, with Japan and Germany suffering the most from projected falls in GDP this year of 6.2% and 5.6% respectively (see chart 2).



In recent weeks there have been some signs that the worst of the recession may soon be over in Britain. Business surveys of purchasing managers are still pointing to continuing contraction but have picked up. Activity in the housing market is now starting to recover a bit, though from an extraordinarily low level. Inventories have been run down fast, which suggests that the economy will be among the first to benefit once companies start meeting demand from new production rather than existing stocks.

It would be foolish all the same to pin too many hopes of an immediate or sturdy recovery on these fragile signs of healing. There is still a lot of economic pain due over the coming months, not least in rising unemployment. The number of people claiming benefits rose by 73,700 in March, a big increase by usual standards though less than the record jump of 136,600 in February. On the broader household-based measure of unemployment, the jobless rate rose to 6.7%, up from 5.2% a year earlier.

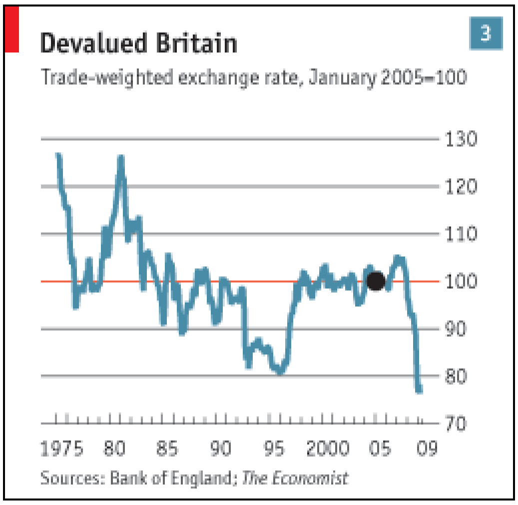
Even so, Britain does look set to fare less badly in comparative terms than was once feared. An essential precondition for resumed growth has been met in the steps taken to prop up its banks. Mr Brown won international plaudits last year for showing the way on financial-system rescues with emergency injections of public capital; but Britain had to act fast, such was the plight of two of its big banks. Even after October's recapitalisations, Royal Bank of Scotland and HBOS, now part of Lloyds Banking Group, required much more help. The crucial step was the Treasury's decision earlier this year to guarantee the two banks against worst-case losses through a scheme covering over £550 billion of their dodgy assets. Together with the provision of more public capital, this appears to have stabilised the banking system for the time being—though at a big potential cost.

With this vulnerable flank secured, Britain has been turning other weak points into strength. One obvious frailty was an over-reliance during the boom years on a now-stricken financial sector for growth. Yet in a global downturn caused by plummeting demand for investment goods, electronics and big-ticket consumer items like cars, it has been the countries specialising in producing these things that have suffered the most. Britain has been less affected because manufacturing makes up only 13% of the economy, compared with shares of around 20% for Germany and Japan. Moreover, industries such as pharmaceuticals and aerospace, less susceptible than capital goods to recessionary downdrafts, are especially important in Britain, points out Stephen Radley, chief economist at the EEF, a manufacturers' organisation.

In another feat of jujitsu, the fall in sterling caused by a general loss of confidence in Britain is now buttressing the economy. Sterling's depreciation since the financial crisis broke has easily exceeded its plunge after Black Wednesday in September 1992, when the pound was kicked out of the European exchange-rate mechanism. Indeed, the 27% decline in sterling's trade-weighted value between July 2007 and March 2009 has rivalled the tumble in the mid-1970s, when Britain was the "sick man of Europe" (see chart 3).

The competitive edge that this has given British exporters is

being blunted by the collapse in foreign markets. Exports of goods fell in volume terms by almost 14% in the year to February. But other countries have suffered far more: in Japan, exports nosedived by 45% over the same period. The weak pound is supporting the economy by making exports more profitable and giving a fillip to domestic producers that compete with imports in the home market.



As important, the falling pound is guarding Britain against deflation, which could be lethal in an overborrowed economy since it pushes up the real value of debt. Official figures showed on April 21st that retail prices fell by 0.4% in the 12 months to March, their first decline since 1960. But the fall was mainly because of the sharp reduction in interest rates: excluding mortgage-interest payments, retail prices rose by 2.2%. And consumer prices, the narrower measure used for inflation targeting, increased by 2.9%, which was still above the government's 2% goal.

As the retail-price figures demonstrate, the economy is getting a lot of help from looser monetary policy. First, the Bank of England hauled down the base rate from 5% in early October to 0.5% in March, smashing one historical record after another on the way. Second, it promptly switched to quantitative easing—buying assets, mainly gilts, and creating the money to do so—in order to boost the money supply and spur lending. This is helping it to retain some influence over the economy even though it has run out of interest-rate ammunition. The new policy is being pursued with gusto, with the bank spending £75 billion over three months.

By contrast, the British economy is getting a smaller fiscal stimulus—the deliberate use of budgetary policy through tax cuts or higher public spending to counter the recession. Mr Darling had already announced in November a fiscal boost for 2009-10 worth 1.1% of GDP, to which he added a further 0.5% this week. But with fiscal policy slightly contractionary the following year, Britain's total stimulus over the two years is considerably lower than America's or Germany's.

Despite the heated rows in the run-up to the London G20 summit on April 2nd about the discretionary use of fiscal policy, deliberate stimulus is only part of the story. As European leaders opposing American pleas for more fiscal stimulus pointed out, automatic stabilisers—the fall in tax revenues and rise in welfare spending that occur anyway during a downturn—also support the economy. When these are taken into account, the budgetary loosening in Britain comes much closer to America's.

What this means is that the ailing British economy has had three powerful doses of medicine: the fall in sterling, a dramatic easing in monetary policy and some fairly hefty fiscal support. Moreover, the worst-affected banks have received big infusions of public capital backed up by catastrophe insurance on their dodgy assets. This mix of measures seems likely to keep GDP from falling as far as in some other big countries, even though the outcome will be grim by historical yardsticks.

The economy itself may not prove the worst-performing in the G7 but the public finances certainly look set to be. On figures from the IMF this week, Britain's budget deficit in 2010 will be the highest as a share of national output in the G7. When he was chancellor, Gordon Brown set a much-trumpeted fiscal rule to keep public net debt below 40% of GDP. The new budget revealed that the debt burden will double to almost 80% by 2013-14 (see chart 4).

A red river of debt

One reason is that Britain's starting-point was poor. In 2007-08 it ran a deficit of 2.4% of GDP, even though the economy was growing fast and had enjoyed all those years of expansion of which the prime minister was so inordinately proud. During his decade at the Treasury, Mr Brown at first both professed and practised prudence, but he then embarked unwisely on a prolonged public-spending spree that involved heavy borrowing.

Even allowing for the fact that Britain's budget was already in deficit in 2007, its deterioration by 2010 is also set to be the G7's

biggest. One main reason is that Mr Brown came to rely on fickle revenues from overheated property markets and frothy finance. These two sources accounted for half the increase in total receipts between 2002-03 and 2007-08. Financial companies were paying around a quarter of total corporation-tax receipts and its highly paid workers were contributing a rich bounty in income tax. But between 2007-08 and 2009-10, revenues from finance and housing will shrink by almost 2% of GDP, and will then stage only a sluggish recovery.

Trying to borrow on the scale now envisaged by the chancellor would once have seemed preposterous. Yet with private investment slack, the Treasury should be able to tap savings. A crucial point is whether financing costs remain low. When borrowing last bulged because of a recession, in the early 1990s, gilt yields were much higher, which made the burden of greater debt more painful. That is why it was important to reassure investors on April 22nd that the government will get a grip on the public finances.

One risk investors will worry about, especially now that the Bank of England is creating money to purchase gilts, is that the government might seek to inflate its debt away. But the bank is charged with meeting the inflation target, which remains 2%. It adopted the policy of quantitative easing in order to ward off deflation, not to wriggle out from under debt.

Britain does have one advantage as its borrowing and debt soar. It entered the recession with relatively low levels of public indebtedness compared with other big countries. That means that even with a dramatic surge in liabilities (and these are also rising elsewhere) it will end up with only a middling level of debt compared with G7 countries overall.

AP

And now for our next trick

Even so, with so much public debt heading down the slipway, the chancellor needed to show credible plans for cutting the deficit once the recession is over, setting out a tougher stance from 2011-12. Already, in his November financial statement, he had indicated that spending would grow more slowly, including a cash freeze on net investment. That accounted for most of the planned reduction in borrowing, with the rest coming from a recovery in tax revenues and some modest tax-raising measures.

Mr Darling’s fiscal tightening went farther in the budget. The growth of current spending will be curbed even more, rising by just 0.7% a year in real terms between 2011-12 and 2013-14. Investment will fall sharply as a share of GDP, from 3.1% this year to 1.3% by 2013-14, rather than to 1.8% as envisaged in the pre-budget report. As usual when the public finances are in a mess, the Treasury is axing capital spending—a practice Mr Brown once abhorred.

About a third of the discretionary tightening will come from higher taxes. The most eye-catching was the decision to raise the top rate of income tax, currently 40%, to 50% on earners above £150,000 from 2010. In November Mr Darling had planned a top rate of 45%, to take effect a year later. The Treasury expects the tax to raise £2.4 billion in 2012-13. Other soak-the-rich tax increases, including a reduction on pension-tax relief for high earners, will be adding a further £4.6 billion by then.

Mr Darling’s plans will do something to bring down borrowing, but not enough. They rely heavily on bullish growth forecasts, especially from 2011. The budget was too much about political point-scoring and not enough about sorting out the public finances. But that may matter less than it seems. With a general election due by June 2010 at the latest and Labour far behind in the opinion polls, the Conservatives are likely to be in charge when Mr Darling’s strategy is to be implemented. Under David Cameron, the Tories have recently been seeking to depict themselves as a party that will do whatever is needed to clean up the fiscal mess.

That means a lot more pain for ordinary people than Mr Darling has let on. His measures go only a third of the way to putting the public finances back on a sustainable footing, says Carl Emmerson, deputy director of the Institute for Fiscal Studies, a think-tank. More tightening must follow.

And elsewhere, too, for Britain’s unhappy taxpayers are not alone in their misfortune. Across the world, the bill for this recession will be a big increase in public indebtedness. With electorates hostile to inflation, debt will have to be worked down the hard way, through serious cuts in public spending and higher taxes.

The banking crisis has been heralded in many quarters as the end of free-roaming market capitalism and the rebirth of government intervention. Certainly states will be taking a far closer interest in what goes on in banking and finance in the years ahead. But whatever politicians’ ideological aspirations, government is more likely to retreat than to advance. Deficits, debt and the need for fiscal retrenchment will make sure of that.

Tim Geithner

Baptism of fire

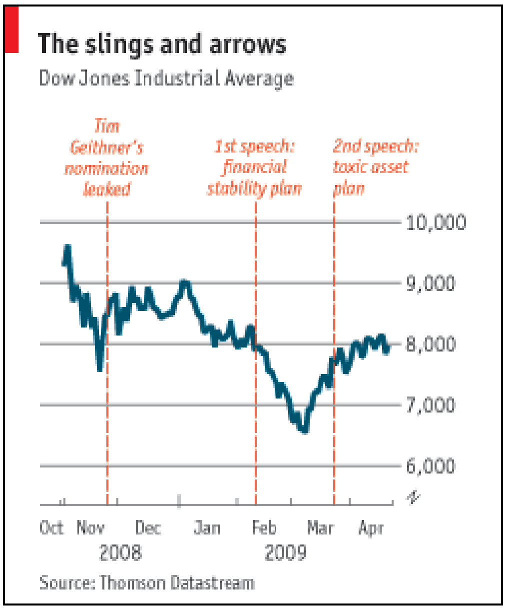
Apr 23rd 2009 | WASHINGTON, DC
From The Economist print edition

The treasury secretary is torn between politics and policy

Reuters

ASKED after giving a speech on April 22nd whether he regretted taking his new job, Tim Geithner, Barack Obama's treasury secretary, paused for what seemed an eternity. "I…uh…feel deeply privileged," he replied. His audience erupted in laughter.

Mr Geithner's first three months have been a baptism of fire. The markets soared last autumn (see chart) when the New York Fed chief's name surfaced for the job. But within weeks of taking office in January, personal tax problems, a poorly received plan for fixing the financial system and a backlash against his bail-out of AIG, a big insurer, had some in Washington, DC, counting the months to his resignation.



Talk of resignation has died down as markets have recovered amid renewed hope about the economy. The outrage over AIG burned itself out. And Mr Geithner has scored some successes: he has proposed new federal powers to take over failing financial institutions and he led the way for the G20 to boost the International Monetary Fund's credit by $500 billion to support cash-starved countries.

Even so, Mr Geithner has not yet silenced the sceptics. In a town full of people steeped in politics but short on substance, Mr Geithner is the opposite. Few question his policymaking qualifications. As an aide to previous treasury secretaries, then as president of the Federal Reserve Bank of New York, he earned a reputation for rapid analysis and decisive responses.

However, he did that job mostly behind closed doors and, thanks to the Fed's independence, with few political constraints. Being treasury secretary requires some rather different skills. These include showing empathy with working people, patiently nursing deals through Congress, and beating back competing and usually strident interests. Mr Geithner speaks quickly, peppering his speeches with jargon that resonates more with economists than with congressmen. On several occasions Mr Obama has been able to explain

Treasury plans better than Mr Geithner. “Barack Obama for treasury secretary,” one blogger, Felix Salmon, quipped.

Still, resolving the current crisis would test even the most battle-hardened politician’s skills. That is largely because fixing the financial system means putting public money into the same banks and other financial institutions that the public blames for causing the crisis. The cost is obvious, while the main benefit—avoiding a catastrophic downward cycle of contracting credit and recession—is, mercifully, hypothetical, no matter how plausible. If the bail-outs work, it will be hard to prove conclusively that they were needed.

This means that Mr Geithner has had to come up with solutions that may sacrifice economic effect for political legitimacy. To relieve the banking system of dud loans, Mr Geithner considered, then rejected, a government-run “bad bank”, as Sweden and South Korea had previously used, because it was vulnerable to accusations of overpaying for assets. His solution, a “public-private investment programme”, or PPIP, relies on investors to negotiate a price with banks, although they will be subsidised by government-backed loans.

A bad bank might also have required money that Congress at present is not inclined to grant. Mr Obama’s proposed budget does in fact pencil in $750 billion more in bail-out money. But Mr Geithner will not ask for it until he is sure he needs it. He has argued that the PPIP is superior to a bad bank, but the weight of expert opinion, as he surely knows, disagrees.

Mr Geithner sought early on to hold banks accountable for the bail-out money. But, fearful of driving banks and investors away and so neutering the effort, he and Larry Summers, Mr Obama’s White House economic adviser, have consistently resisted imposing conditions as strict as some in Congress would like.

For the same reason, they have resisted calls simply to nationalise the banks. Mr Geithner and Mr Summers want to preserve the banking system largely as it is, in private hands: advocates of nationalisation simply do not appreciate the long-run damage it would do to the efficient functioning of the economy. This is a valid point, but it has exposed them to accusations of identifying too closely with bankers. At a meeting with a congressionally picked panel charged with overseeing the $700 billion Troubled Asset Relief Programme (TARP) on April 21st, Mr Geithner had to correct a questioner who thought he had once been an investment banker.

Mr Geithner presented a comprehensive explanation of the causes of the crisis, his response, the state of the economy and regulatory reform. But impatient panellists wanted to focus on whether banks were getting too sweet a deal. “How does protecting Citi’s common shareholders at the expense of taxpayers benefit our economy?” one demanded.

The TARP is being overseen by no fewer than three separate bodies, and at times it seems they have more employees than the Treasury Department has administering TARP (Mr Geithner still remains the Treasury’s only Senate-confirmed official). This week Neil Barofsky, the New York lawyer who was appointed as the programme’s inspector-general last year, has recommended that any firm participating in PPIP should have to disclose the names of its beneficial owners—such as hedge-fund partners. He has also suggested such firms might be subject to the same executive-pay restrictions as banks that have been bailed out now are. Such conditions could well drive investors away.

The markets are another tough constituency for the treasury secretary. They have priced many banks as insolvent. By contrast, Mr Geithner and Ben Bernanke, the Fed chairman, think that most American banks are well-capitalised and able to lend. Stress-test results due early next month will identify the few that need more capital. But markets, like voters, don’t have to be right to affect the outcome of Mr Geithner’s policies. If their stocks fall, it will make it harder for banks to raise new capital and for the economy to revive.

On the other hand, if the programmes work and today’s green shoots become a full recovery, Mr Geithner will get a lot of the credit. That does not mean his life will get easier: once the crisis is over, he will have to tame the national debt and overhaul America’s antiquated financial regulations. Mr Geithner claims to relish the challenge. “You have to be here at this moment, doing this,” he said in his answer to whether he regretted taking the job. “There is no plausible alternative.”

Climate change

A green figleaf

Apr 23rd 2009
From The Economist print edition

The EPA's decision on greenhouse gases provides a boost for gloomy greens

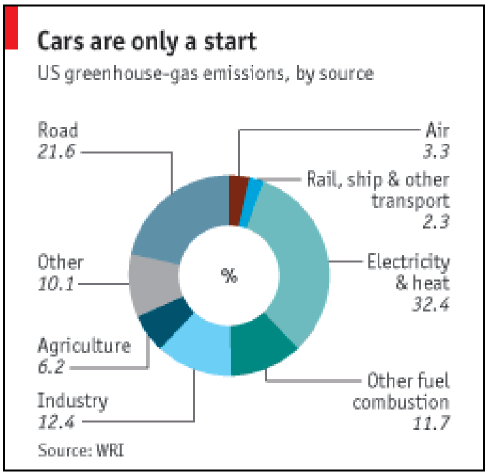
THE decision on April 17th by the Environmental Protection Agency (EPA) that six greenhouse gases are a danger to the environment and to human health has come at a good time for the green lobby. It needed a boost; for hopes in Washington, DC, that Congress will pass legislation to control emissions before December, when the world gets together in Copenhagen to decide what to do when the Kyoto protocol runs out, are low—and falling.

The EPA has been mulling the harmfulness of greenhouse gases since 2007, when, in a case brought by a coalition of states, cities and NGOs, the Supreme Court ruled that it should regulate greenhouse gases if they were found to be toxic. As expected, the EPA, now run by Lisa Jackson, who brings to the job 20 years of experience as a regulator who's tough on business, gave a provisional ruling that they were; a final decision will come after a 60-day period of public consultation.

Legislation to cap carbon emissions, though supported by the administration, is struggling to get through Congress. So greens are delighted, because the EPA's decision allows emissions to be regulated under existing rules. Businesses and congressmen who dislike the idea of legislating to control emissions may now decide that a new law, over which they can have some influence, would be better than regulation through an old one. According to Edward Markey, co-author of the main cap-and-trade bill in the House, "it is no longer a choice between doing a bill or doing nothing. It is now a choice between regulation and legislation."

But the decision is not as momentous as it seems. It applies principally to emissions from motor vehicles, which are responsible for under a quarter of man-made carbon-dioxide in America. Attempts to extend it to other sources of greenhouse gases may prove more difficult and would almost certainly face challenges in court. And environmental cases tend to drag on and on. *Massachusetts v EPA,* the case that led to this decision, was filed six years ago; the Exxon Valdez case took 19 years. "The *Jarndyce v Jarndyce* factor is very strong in America," according to Paul Bledsoe of the National Commission on Energy Policy. Advocates of control understandably prefer a legislative approach.

Thanks to the energetic sponsorship of Henry Waxman, chairman of the Energy and Commerce Committee, the cap-and-trade bill has momentum in the House. But Mr Waxman's bill, which is regarded as extremely green in Washington, may have to be watered down if it is to gain the approval of its many opponents from coal states, in the Democratic as well as the Republican Party. And if it gets through the House—which, in some form, it probably will—its chances in the Senate are slim. They are reckoned to have shrunk lately, as the administration is seen as focusing more on health-care reform, thus using up time and political capital which might otherwise have been allocated to climate change.



Going to the Copenhagen conference without legislation in place will be embarrassing for America, especially since other bits of the world are forging ahead. In December, in the face of much opposition, especially from eastern Europe, the European Commission got member states to agree to its "20-20-20" plan to reduce emissions to 20% below 1990 levels by 2020. China's economic stimulus package includes twice as much green spending as America's does. If America's legislators threaten to send the country's representatives into the conference room naked, the EPA's decision, which means that tailpipe emissions at least are likely to be regulated, has provided them with a figleaf.

Illinois

Pruning a jungle

Apr 23rd 2009 | CHICAGO
From The Economist print edition

Reformers take on murky politics

THE political history of Illinois does not make for edifying reading. In the 19th century Chicago's politicians fed work-hungry immigrants, trading jobs for votes. “Big Bill” Thompson, Chicago's mayor for much of the prohibition period, had ties to Al Capone. A former secretary of state died in 1970 with $800,000 hidden in shoeboxes. A 2004 scandal sent underlings of Richard Daley, Chicago's current mayor, to prison. In all 1,000 businessmen and officials, including three governors, have been convicted of corruption since 1970, reckons the University of Illinois at Chicago. Rod Blagojevich may soon join the list. The former governor, who was removed from office in January, pleaded not guilty to federal charges earlier this month.

New proposals are now trying to uproot bad old tradition. The Illinois Reform Commission (IRC), appointed by Mr Blagojevich's successor, Pat Quinn, will issue recommendations for reform on April 28th. Several state politicians, eager to prove their integrity, have ideas of their own. The legislature must act by May 31st, the end of the session. It is a tough task.

Illinois is exceptionally corrupt. It is also exceptionally lawless. The Watergate scandal in the 1970s prompted Congress and state legislatures to limit campaign contributions. Illinois remains one of only four states without any such caps. Reforms have mostly “nibbled around the edges”, explains Cynthia Canary of the Illinois Campaign for Political Reform. It was not until 2008 that Illinois passed a law that might seem pretty fundamental: officials in charge of awarding big state contracts may no longer accept contributions from firms seeking those contracts.

Mr Blagojevich's alleged exploits include plotting to sell Barack Obama's Senate seat; the charges against him are so glaring that they may inspire real change. Patrick Collins, a former federal prosecutor and the head of the IRC, is trying to close as many loopholes as he can. Suggestions include strict limits on contributions from individuals and political committees. A new office, insulated from political pressure and overseen by an independent monitor, would award state contracts. More recommendations are to come next week.

It is anyone's guess whether these or other proposals will survive. Mr Quinn wants the state Senate and House to vote on each of the IRC's measures, a move that would help avoid death by subcommittee. Nevertheless, state leaders may be loth to overhaul the rules that elected them.

Even if the reforms are enacted, Illinois is unlikely to change overnight. Laws can only do so much. After Congress limited individual contributions in the 1970s, spenders simply diverted their cash to political parties. Limits on contributions to parties in 2002 did nothing to curb spending by independent committees. Corruption, meanwhile, is a persistent weed likely to grow through cracks.

Still, Connecticut provides a hopeful model, says Ciara Torres-Spelliscy of the Brennan Centre for Justice in New York. That state's governor resigned in scandal in 2004; thanks to wide reforms “Corrupticut's” most recent election saw more than 70% of state legislators participate in public financing. “The cynical side of most of us believes that Illinois can't be cured,” says Mr Collins. “I can't accept that.”

The World Trade Centre

Slow building

Apr 23rd 2009 | NEW YORK
From The Economist print edition

The towers will rise again. Probably

AP

LAST year 1.5m people visited St. Paul's Chapel, near the World Trade Centre (WTC) site, to view its September 11th exhibit where banners, memorials and photographs of the "missing" are on display. The chapel was a place of refuge for the rescue workers and the clean-up crew in the months after the 2001 attacks. A still grimy pew with scuff marks from the boots of sleeping rescue workers is especially moving. But there is little else to see; most of the 16-acres (6.5 hectares) of the former WTC is still a construction site. Only one replacement building has been completed.

Years of bureaucratic bickering set things badly behind. Although the construction of the Freedom Tower (pictured), its 1,776-foot high (541m) centrepiece and the memorial are at last under way, the collapsed credit market looks likely to delay the rest of the redevelopment further. Larry Silverstein, who holds the site's lease, is unable to secure the funding he needs and has asked the Port Authority of New York and New Jersey, which owns the site, to help him. The Port Authority commissioned its leasing agent to analyse the risk involved. The supposedly confidential, but widely leaked, study found that the leasing prospects for the new office towers are not good. One of the planned towers, it reckoned, would not be filled with tenants until 2037.

Janno Lieber, who heads Mr Silverstein's WTC operation, has said the Port Authority's position is based on a "totally pessimistic attitude about New York's economic future". But with many firms cutting staff numbers and some, like Merrill Lynch, leaving lower Manhattan, there is no denying the growing glut. Jamie Dimon, JPMorgan Chase's chief executive, after announcing his firm's first-quarter earnings, predicted "rapidly rising" losses in the commercial real-estate market.

The Port Authority is not willing to risk public money. It has its own problems. Last month it quietly renamed the Freedom Tower "One World Trade Centre", which is the legal address. The former moniker, some say, may have turned off potential tenants. Most of those it has signed up are government agencies. The tower has only one private tenant, a Chinese property developer, and is unlikely to be fully occupied until 2019.

And so the bickering and dithering continues. With luck, New York's mayor, Michael Bloomberg, may intervene again. He successfully brought the two sides together to hammer out a deal in 2006. The memorial, at any rate, is on track to be finished in time for the tenth anniversary of the attacks in 2011.

Universities and the recession

Desperemus igitur

Apr 23rd 2009 | AUSTIN
From The Economist print edition

Students and universities are strapped for funds, with little relief in sight

THE class of 2009 will be almost the largest in America's history. More than 3m students are getting their high-school diplomas in late spring. Those who plan to go on to university have been told for years to expect a rough time: with so many students applying, winning admission to their college of choice will be a challenge. But those who clear that hurdle will find that their problems are just beginning.

College life is an enviable set-up given the job market at the moment. It comes at a price, though: an average of roughly $25,000 per year at a private university, and $6,600 at a state one. That was this year, and next year it will in most cases cost a bit more. That is ominous for students and the people who fund them. Parents have lost jobs, and seen their savings wither. "I think more parents are being emboldened to ask for more money, or to ask for financial aid, period," says James Boyle, the president of College Parents of America.

But few universities are in a position to help. In more than 20 states, cash-strapped legislatures are talking about cutting funding or have already done so. Many public universities are therefore raising tuition fees. The private schools without big endowments are in a tight spot: they need tuition to pay their operating costs.

Top colleges with fat endowments are doing better, but they are still struggling. For years, Yale University's endowment fund posted double-digit returns. In fiscal 2000 it gained 41%. Institutional investors marvelled. The fund's manager wrote a book about it. In December, Yale's president announced that the value of the endowment had fallen 25% since June. That is not unusual. A new study of 235 universities found that their endowments dropped, on average, by 24% in the last six months of 2008.

Students can borrow tuition money, but that has problems of its own. The danger is that they will end up like so many of their older siblings, saddled with loans. Cautionary tales abound. Robert Applebaum, a lawyer in New York, began his legal career as a prosecutor before deciding that, with $75,000 in law-school loans, he could ill afford to stay in the public sector. He started a Facebook group on a whim earlier this year: "Cancel Student Debt to Stimulate the Economy". Three months later, it has more than 180,000 members.

Alamy

Feeling the pinch

The Facebookers have a point. If the younger generation is crushed by debt too early they will not be able to pay for the baby-boomers in retirement. But Sandy Baum, a senior policy analyst at the College Board, says that cancelling all student debt would be arbitrary and irrational. She prefers targeted loan relief: as of July 1st graduates who work in low-paying jobs can have their federal loan payments capped at a certain portion of their income. People who work in public-service jobs like teaching can have part of their federal loans forgiven altogether.

Decision time looms. The college acceptance letters have been arriving during the past month, and in many cases students have to reply by May 1st. Another annoyance for the admitted students is that they have little bargaining power. If they threaten to take their money elsewhere, the college will seldom worry, let alone offer discounts or better loans. There is always a waiting list, and an especially big one this year. But at least this year's crop of young things will find they have plenty of friends in the same boat.

California splitting

Of Ossis and Wessis

Apr 23rd 2009 | BERKELEY
From The Economist print edition

California is now divided more east-west than north-south

THE problem with those lefties on California's coast is that they "love fish, hate farmers," says Virgil Rogers in his Okie twang, so common in California's Central Valley. Actually that's just where the problems start, and he begins to list them. So different are the folks by the sea and in the interior, he says, that the only way forward is to split the state in two.

Thirteen coastal counties, from Los Angeles to Marin, just north of San Francisco, should become the 51st state, to be named whatever they please; the remaining 45 counties would remain simply "California". Based on the reaction he gets at farm fairs, he reckons his recently founded organisation will easily collect enough signatures—the number required is currently around 700,000—to force the split onto the ballot by 2012. Winning, of course, would be an entirely different matter.

Mr Rogers's idea (see map) may be fanciful, but tensions in America's most populous state are nothing new. Proposals to split California go back almost to 1850, when it joined the union. Usually, the problems began with water, which the north of the state had and the south needed, and then spilled over into culture, which was also distinct in north and south. The most famous effort, in 1941, came close to merging California's northernmost counties with several from Oregon to form a new state, to be named Jefferson after America's third president just as Washington is named after its first.

Mr Rogers still remembers that movement, which atrophied after Japan attacked Pearl Harbour and Americans discovered other priorities. Now 90, Mr Rogers came to California in 1940 from Oklahoma in the great migration from the Great Plains' dust bowl. The Okies worked on farms in the Central Valley, then became arch-conservative, red-state farmers themselves in a state that has otherwise gone Democratic blue in recent years.

Now they are fed up. The final straw was a ballot measure passed last November against the close confinement of farm animals, which is just the sort of thing that the coast's "agriculturally uneducated city dwellers" like to foist on the people who feed them, says William Maze, a former state assemblyman who now manages Mr Rogers's organisation. They pass themselves off as "environmental stewards", he says, but are really "unrighteous types" that have never seen a pig or cow up close.

Food is one front in this culture war. Coastal sorts take their cues on the subject from Alice Waters, the owner of a famous restaurant in Berkeley, who has started a movement for food that is not only organic and local but altogether more soulful and sensual. A coastal Californian is much more likely to be picking up heirloom tomatoes at the farmer's market on the way to a yoga studio than to be protesting for more water to irrigate huge inland farms, as many Central Valley residents were doing this month.

But it goes beyond food. The bumper stickers in the coastal counties overwhelmingly scream against a recent ballot measure to ban gay marriage; inland they scream just as loudly in favour of it. All Californians seem to have bumper stickers, but on the coast they are often glued to Priuses. Inland, they adorn pickup trucks.

But the stereotypes may become outdated. Carol Whiteside, a grande dame of the Central Valley, says the influx of Latino migrant workers (who are likelier than not to vote Democrat) and coastal families

fleeing expensive housing is turning the Central Valley “purple”. Even the coast gets more complicated the closer one gets. People in Orange County, on the beaches south of Los Angeles, are increasingly fond of Priuses, but still Republican enough for Mr Rogers’s inland state. Unscrambling California seems a doomed task.

Homelessness

The Hooverville that wasn't

Apr 23rd 2009 | SACRAMENTO
From The Economist print edition

Life in America can be desolate, even without media hype

ON A patch of land between the American River and a bike path on one side and the pylons of a power company on the other, about a half-hour's walk from California's state capitol in Sacramento, men in orange suits have been clearing out the tarps, tents, mattresses, used needles and the other leavings of some 150 homeless people. On April 16th the Golden State's most notorious tent city was at last closed, and its inhabitants moved to rather more salubrious shelters.

The camp shot to national and international fame earlier in the year, when a camera team from the Oprah Winfrey Show arrived. A television audience with a grisly eagerness for depression stories was meant to conclude that California's middle class, being foreclosed upon en masse, was now living in shantytowns. It was Great Depression 2.0, with new "Hoovervilles"—the name given by 1930s Democrats to the shantytowns that sprang up on the Republican President Herbert Hoover's watch—apparently back in evidence. Many other press teams, American and foreign alike, arrived to record their sequels to Steinbeck's "The Grapes of Wrath".

Kevin Johnson, a former basketball star and now Sacramento's first black mayor, found himself on CNN speaking to national audiences, secure in the knowledge that he could not be blamed: in Sacramento, it is the city manager, not the mayor, who wields the main administrative power. Even the governor, Arnold Schwarzenegger himself, dropped in for a surprise walk-through. After all this attention, action became inevitable.

The funny thing, though, is that the tent city had actually been around for close to a decade. There may have been a foreclosed homeowner or two among its denizens, but Justin Wandro, the office manager at nearby Loaves and Fishes, a food bank where the homeless can eat and shower, says that almost all of the people there have problems with mental health, drug abuse or both. Sacramento has about 1,400 homeless people in shelters, and another 1,200 or so on the streets, he says. For some reason, America notices only when they're on Oprah, or from the middle class.

White-collar prisoners

How not to get stuck in jail

Apr 23rd 2009 | WASHINGTON, DC
From The Economist print edition

A service for some of our readers?

AS THE economic tide recedes, it exposes all manner of ugliness, from the gargantuan fraud of Bernard Madoff to books-fiddling at Satyam. But what is bad news for most people means more business for Larry Levine, the founder of Wall Street Prison Consultants, which teaches white-collar criminals how to survive prison.

Mr Levine, a former private investigator, knows whereof he speaks: he spent ten years shuttling between 11 federal prisons on charges related to narcotics, obstruction of justice and securities fraud. He remains under supervised parole, which means he must conduct all of his business by telephone (passing time in the company of other convicted felons is a parole violation, and would result in his returning to jail). He calls himself a jailhouse litigator (“jailhouse lawyer”, he explains, “sounds cheap”). Long stretches in his prisons’ law libraries left him more familiar with the Byzantine rules of America’s federal prison system than most wardens.

He first made something of that knowledge towards the end of his sentence, in 2005, when he sued the Federal Bureau of Prisons on behalf of about 100 terrified white-collar prisoners who were transferred en masse from a minimum-security prison (the type derisively called “Club Fed”) to a low-security prison where they shared space with gang members and other violent criminals.

Hundreds of terrified fraudsters later, Mr Levine’s business is thriving. Starting at $999 per consultation, he advises criminals on all aspects of prison life. How can you advance your release date? Many prisoners suddenly discover, post-conviction, that they had a drinking problem (participating in rehab shaves time off sentences). Where should you look for friends? Do not cross racial lines—many federal prisons are so segregated that they have “black” telephones and “white” telephones—and do not make friends with a “rat”, or known informant. What about prison etiquette? Do not sit on another inmate’s bunk without being invited to do so, do not change the television channel when someone else is watching and do not jump in line. Show respect to everyone (Mr Levine cautions that reaching across someone’s tray at the dining hall is a good way to get yourself “stuck”, or stabbed).

Still, even Mr Levine can’t help everyone. He is pessimistic about Mr Madoff’s chances of leaving prison alive. Thieves rank low in prison hierarchy, and he reckons that other inmates whose families have been hurt by the downturn will blame Mr Madoff. “You rob a bank, that’s cool,” he explains. “Someone defrauded an insurance company, and he’s cool. The worst thing you can be in prison is a thief who steals from people, and Bernie stole from people.”

Lexington

After the dark side

Apr 23rd 2009
From The Economist print edition

Barack Obama is trying to find a new balance between national security and human rights

Illustration by KAL

DURING a public meeting in Istanbul on April 7th Barack Obama argued that the American ship of state is more like a supertanker than a speedboat. You cannot just spin it around and point it in a new direction; instead, "you've got to slowly move it and then eventually you end up in a very different place."

Ever since the Obama administration released the Justice Department's so-called "torture memos" on April 16th Americans have been debating what Mr Obama's "very different place" might mean for counter-terrorism. The memos make disturbing and surreal reading. Disturbing because of the brutality they describe (one man was waterboarded 183 times in a month). Surreal because they combine the torturer's language with that of the health-and-safety inspector (slamming someone into a wall, or "walling" them, is acceptable, provided that the wall is "flexible" and "the head and neck are supported with a rolled hood and towel that provides a c-collar effect to help prevent whiplash").

The memos have also stirred a debate about the future of counter-terrorism. How far will Mr Obama go in rolling back the extraordinary powers of surveillance and secrecy, detention and interrogation that the Bush administration accumulated? And how much danger is there that he will overreact to his predecessors' excesses, leaving his country vulnerable to another attack?

Mr Obama has repeatedly signalled that he will fulfil his campaign promise to turn the page on a dark chapter in American history. On his first day in office he said that he was suspending the military tribunals at Guantánamo Bay. Two days later he signed executive orders banning the CIA's secret prisons and "enhanced interrogation" techniques, bringing America's policies on detainees in line with international treaties; he also ordered Guantánamo closed within a year. Many of his supporters regarded his decision to release the torture memos as another example of his determination to break with the past.

But Mr Obama has always been careful to leave himself plenty of wriggle room. Elena Kagan, his solicitor-general, has argued that it may still be necessary to hold some former Guantánamo inmates indefinitely. Mr Obama has not ruled out extraordinary rendition, the practice of sending people suspected of terrorism to other countries for "interrogation". He has also appointed John Brennan, a

veteran CIA figure, as his counter-terrorism adviser, despite the fact that Mr Brennan was passed over for the job of director of the CIA because many Democrats thought that he was too hardline.

Mr Obama has also continued the Bush administration's practice of urging civilian courts to throw out cases that involve allegations of rendition and torture. In February Mr Obama's Justice Department persuaded the Ninth Circuit Court of Appeals that a lawsuit on behalf of a Guantánamo detainee, Binyam Mohamed, who also suffered extraordinary rendition, should be dismissed on the ground that it would disclose state secrets.

Mr Obama's taste for trying to balance both sides of an argument is evident in his handling of the torture memos. He has repeatedly said that he will not prosecute people who were simply obeying orders ("this is a time for reflection, not retribution"). He visited CIA headquarters this week to tell the spooks how much he values their work, and to reassure them that he understands the importance of protecting their identities. But he has also hinted that his administration may establish a "truth commission" to figure out just what happened, and that those responsible for designing the policy of harsh interrogation might face prosecution.

This is partly an attempt to have it both ways, of course. But there is more to it than that. Mr Obama inherited some very difficult problems from the previous regime, not least what to do with people, some of them highly dangerous, who have been in a legal limbo in Guantánamo for years. Conservatives are right to be irritated by foolish liberal claims that America does not face any hard choices in fighting terrorism. But it is equally idiotic to argue, as a fair few conservatives seem to, that tough-minded policies are meritorious simply because they are tough-minded.

Own goal

A pointed objection to George Bush's policies is not just that they crossed a moral line but that they crossed it to no purpose. Mr Bush's critics were not confined to bleeding-heart liberals who are even now making a fuss about the rights of a captured Somali pirate. They included a legion, from high-ranking commanders to military lawyers to intelligence operatives, who argued that the techniques were counterproductive.

"Enhanced interrogation" acted as a potent recruitment tool for terrorist organisations. It made it more difficult for America to co-operate with allies, particularly in Europe. It imposed personal burdens on front-line workers who found their values compromised. Dick Cheney points out that the techniques yielded some useful information. But the same information might have been obtained by less controversial means. Torin Nelson, a veteran interrogator, says the administration made a fundamental mistake in focusing on how far it could push detainees, not least because people who are tortured will often confess to anything. It would have been better off recruiting and training more skilled interrogators who knew how to win the trust of their subjects.

There is always a chance that Mr Obama will go too far, replacing Mr Bush's excessive zeal with excessive timidity. But so far the signs are that he is producing a reasonable balance. He recognises that September 11th 2001 changed the rules of national security. But he also recognises that many of the Bush-era policies were clumsy as well as questionable. The most important comment on Mr Obama's approach to counter-terrorism so far came on April 20th, from the CIA agents who cheered him to the rafters.

An interview wtih Mr Nelson is at economist.com/audiovideo/unitedstates

Ecuador's election

Revolution! Please give generously

Apr 23rd 2009 | QUITO
From The Economist print edition

Rafael Correa (pictured centre) has his country's politics firmly under control, its economy much less so

EPA

HE MAY be Latin America's least predictable "21st century socialist", but Rafael Correa seems assured of victory in a presidential election to be held on April 26th. This in itself is an achievement. The general election, held under a new constitution promoted by Mr Correa, comes just 29 months after he was first elected. But no Ecuadorean president has secured a second consecutive term since the 19th century, and none of Mr Correa's three elected predecessors managed to finish their terms. In addition, his Alianza País (Country Alliance) party is likely to gain a majority in the legislature, though it may fare less well in mayoral votes. So the president will probably be in a stronger position to tackle his country's acute financial problems.

How he will do so is hard to say. Mr Correa's portrait, head tilted back like a clean-shaven Che Guevara, is stencilled on election posters all over the country. He claims to lead a "Citizen's Revolution". Alianza País calls its leadership the politburo, and Mr Correa rages against the World Bank and the IMF.

But unlike Venezuela's Hugo Chávez, a former army officer, or Bolivia's Evo Morales, who is of poor Amerindian origin, Mr Correa is a middle-class economist with a doctorate from the University of Illinois. He can be pragmatic. He has sacked some leftists in his government (though others remain), is friendly to mining companies and is fond of making PowerPoint presentations as the analyst-in-chief.

Mr Correa appears to be uncorrupt. The giant increase in public spending he has overseen (it rose by 71% last year) has resulted in new schools and hospitals. Testing of teachers, with pay linked to results, has been introduced. When talking to an educated audience, Mr Correa stresses the need to improve the country's economic competitiveness.

All this has led some American diplomats to hope that Mr Correa can be detached from the orbit of Mr Chávez. But his anti-Americanism is visceral. His father spent time in an American prison for transporting drugs and committed suicide after returning to Ecuador. President Correa has decided not to renew the lease under which the United States operates drug-surveillance flights from an airbase in Ecuador. In February, he expelled two officials at the American embassy.

Ecuador has enjoyed nine years of economic growth since a financial collapse wiped out its banking system and its currency in 1999 (it adopted the dollar instead). Poverty fell from 52% in 1999 to 35% in

2008. But much of this growth was underpinned by the rise in the price of oil, the main export. Its fall has left Ecuador with a balance-of-payments deficit (see chart).

This has been aggravated by the rise in the value of the dollar in relation to the currencies of Ecuador's neighbours. Mr Correa responded by raising tariffs on hundreds of goods, breaking trade agreements with his Andean neighbours. To make matters worse, remittances from the 2m or so Ecuadoreans living abroad are falling.

The government now faces a fiscal gap of perhaps $2 billion, calculates Margarita Andrade of Analytica Securities, a Quito brokerage. So assuming that he is re-elected, Mr Correa's first task is to ensure that his country does not run out of cash. Where could the money come from? Nobody will buy Ecuadorean bonds for a while. Having announced that two bond issues—those maturing in 2012 and 2030—were "illegitimate" and would not be honoured, the government promptly bought lots of them back at worse-than-junk prices. On April 20th it announced a scheme to buy back the rest at around 30 cents on the dollar.

This might just make it easier for Ecuador to go to the IMF, which requires countries not to be in dispute with bondholders. But Mr Correa has repeatedly lambasted the fund. There are other options. Social-security funds have been raided to prop up the budget. Judging by the brisk demand for safe-deposit boxes in banks, savers are concerned that the government may raid their deposits too.

Various regional lenders will help out before that happens. Ms Andrade reckons that the government could raise up to $500m from the Latin American Reserve Fund and a similar sum from the Inter-American Development Bank. The Andean Development Corporation may provide another $500m.

The government is also talking to China about a cash infusion of $1 billion in exchange for the right to drill for oil, and a $1.7 billion investment in power generation. Even that might not be enough. If the economy worsens, the more impulsive and ideological Mr Correa may overcome the more sensible one. In that case, Ecuador might ditch the dollar and lose its precarious stability.

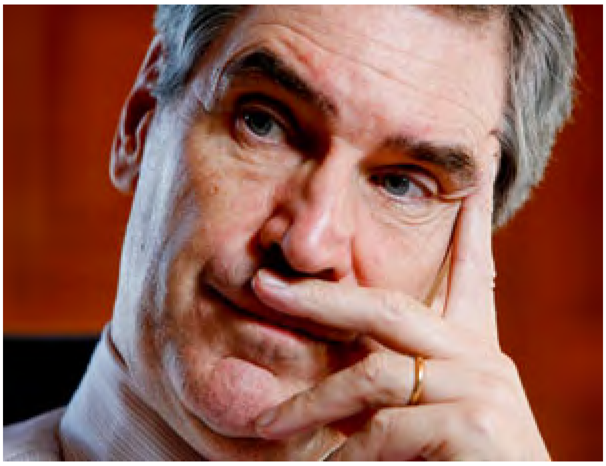
Canada's Liberals

The Ignatieff revival

Apr 23rd 2009 | OTTAWA
From The Economist print edition

At last, a credible opposition leader. Now he needs a few policies

Bloomberg



WHEN Michael Ignatieff, the interim leader of Canada's Liberal Party, bounded to the stage at a packed fund-raising meeting last month, the choice of musical backing was a 1970s rock hit called "You Ain't Seen Nothing Yet". That was an unsubtle message from party organisers that great things are expected from Mr Ignatieff, a former journalist and Harvard academic. Yet the song was also appropriate for a less flattering reason. More than five months after the Liberals, the main opposition, dumped Stéphane Dion and replaced him with Mr Ignatieff, the new leader has yet to set out where he and the party stand on many issues.

There is plenty of time for that, insists Mr Ignatieff. Details will be revealed "little by little". For now Liberals are relieved that their new leader is hauling them back to political competitiveness after losing the last two federal elections to Stephen Harper, the Conservative prime minister.

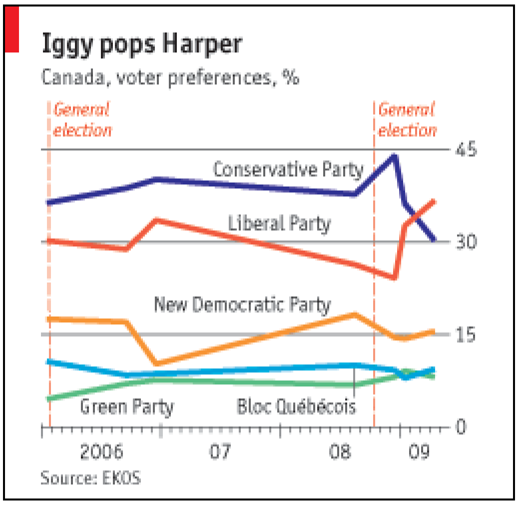
In the second of those, in October, Mr Dion presided over the party's worst showing ever. His final gambit was to try to topple Mr Harper's minority government just weeks after the election by forming a disparate and stillborn coalition with the separatist Bloc Québécois and the leftist New Democratic Party (NDP). Mr Harper survived by shutting down Parliament for seven weeks, Mr Dion departed and Canadians quickly became more exercised by recession and job losses than by party shenanigans in Ottawa.

Mr Ignatieff is due to be crowned, unopposed, as the Liberals' permanent leader at a party convention in Vancouver starting on April 30th. The latest opinion polls give his party a significant edge, enough to form a minority government if replicated in an election (see chart).

But what does he stand for? Opposition parties in Canada, as elsewhere, have learnt to their cost that it does not pay to be too specific before an election. The Conservatives' successful attack on Mr Dion's plan for a carbon tax last year remains a painful memory. Mr Ignatieff ushered the carbon tax out with Mr Dion. He prefers a cap-and-trade system for emissions. And he has also dropped the idea of a coalition with the Bloc Québécois and the NDP.

Mr Ignatieff's message has been vague and general: that the Liberals believe in an activist federal government with a national vision whereas the Conservatives do not. Within this framework, he has suggested strengthening the ties between the east and west of a vast, thinly populated country through a better

electricity grid, a high-speed railway from Windsor to Quebec City and a national child-care programme. “The prime minister of Canada has one job and one job only: to hold the country together and leave it stronger, more united, than when he found it,” he says. As for foreign policy, Canada should look beyond North America now that “the noon hour” of the United States and its global dominance are over, he argues.



For now the Liberal leader is content to remain an enigma. “People like Ignatieff because he is not Stéphane Dion and he’s not Stephen Harper,” says Paul Adams of Ekos Research, a polling company. “But he’s still not defined in the public mind.”

Mr Ignatieff has had other priorities. One has been to reassure Canadians of his commitment to the country despite having spent most of his adult life abroad, in Britain and the United States. When he returned in 2005 and entered politics, he was resented by some as a carpetbagger. To try to change this perception, he published this week “True Patriot Love”, a slim volume in which he explores his Canadian roots. “Enthusiastic flag-waving and empty generalisations,” said a review in *The National Post*, a conservative newspaper.

The Liberals’ other priority has been to repair their party machine. Strict new limits on political donations have hurt the Liberals, who usually looked to business for money, more than the Conservatives, who are better at grass-roots fund-raising. To catch up, the Liberals recently bought software used by Barack Obama’s campaign in last year’s American election, and have centralised fund-raising. Rocco Rossi, the party’s national director, claims that it will pay off its debt within weeks. He is preparing for a possible election in the autumn.

The Conservatives have so far found Mr Ignatieff hard to attack. The Liberal leader surprised some Canadians by defending Alberta’s tar sands when their environmental record was attacked by *National Geographic* magazine. That brought criticism from the left. Conservative MPs pounced on a remark that tax increases would be needed to plug the fiscal deficit.

Mr Ignatieff acknowledges that his foes will seek ammunition among his writings and talks during a long career as an intellectual. His frequent use of “we” when addressing audiences in the United States may be turned against him. So too might his flirtation with the use of torture and his support for the war in Iraq (since recanted), a deeply unpopular cause in Canada. The next election may be both closely contested and dirty.

The United States and Latin America

The charming neighbour

Apr 23rd 2009 | MEXICO CITY AND PORT OF SPAIN
From The Economist print edition

Barack Obama offers a new partnership

Reuters

A hard man for Chávez to hate

AFTER Europe earlier this month, it was Latin America's turn to enjoy Barack Obama's charm offensive. In a brief visit to Mexico City, he assured President Felipe Calderón of his support against Mexico's drug gangs. He went on to Trinidad for the Summit of the Americas, where he dispensed smiles, handshakes and backslaps, and called for a "new beginning" in the relationship between the two halves of the region. It seemed to work. The prime minister of St Lucia asked Mr Obama for an autograph. Even Hugo Chávez, Venezuela's anti-American president, was disarmed. He repeatedly shook hands with the leader of the country he calls the "empire", saying "I want to be your friend". Seven months ago, he kicked out the American ambassador, a step he now wants to reverse.

How much substance lurks behind the smiles? Latin America wants Cuba to return to the diplomatic concert of the Americas. Mr Obama has allowed Cuban-Americans to travel freely and send money to the island. But reversing his position in his senatorial campaign of 2004, he said he did not favour an immediate lifting of the broader American economic embargo against the island.

In practice, the issues of drugs and security are likely to overshadow all others in the Obama administration's relations with Latin America. In Mexico City Mr Obama repeated the soothing message already delivered by several of his cabinet members, that America has a "shared responsibility" for Mexico's security problem because of its demand for drugs and the southbound traffic in guns and cash.

Mr Obama has begun to back up this rhetoric. He has added border agents, ordered inspections of Mexico-bound trains and stepped up efforts to seize the assets north of the border of three Mexican trafficking gangs. Mexican officials are also pleased that the administration is making more of an effort to trace guns.

But some big issues remain unresolved. Under the Mérida Initiative of 2007, the Bush administration promised Mexico $1.4 billion in aid over three years, most of it for helicopters and surveillance and inspection equipment. Congress took nine months to approve the aid; in February it sliced $150m from it. None of the money has yet been paid out. Mr Obama promised to expedite its disbursement, but gave no timetable.

Trade and immigration have also become issues which divide the two countries. Mexico's government is pleased that Mr Obama has backed away from his campaign promise to renegotiate the North American Free Trade Agreement. But Congress recently cancelled a pilot programme allowing Mexican trucks to operate north of the border, prompting Mr Calderón to impose retaliatory tariffs on American goods. "We need to fix the trucking provision," Mr Obama said in Mexico City, but gave no indication of when or how.

While he has declared his commitment to immigration reform, his administration has not agreed to a request from Mexico not to separate families by deporting those of their members who lack documents.

Overall Mr Obama's trip was a success. Several Latin American governments complained that the summit communiqué did not condemn the American embargo against Cuba. But Brazil's Luiz Inácio Lula da Silva hailed "a new way of viewing each other and of overcoming our differences by debating them". Whether the new mood will survive the worsening recession in Latin America is unclear. On April 22nd the World Bank, the Inter-American Development Bank and other donors said that they are ready to lend $90 billion to the region over the next two years. It is unlikely to be enough.

Kidnapping in Colombia

How many hostages?

Apr 23rd 2009
From The Economist print edition

More than the government claims

LAST year millions of Colombians took to the streets to protest against hostage-taking by left-wing guerrillas, right-wing paramilitaries and common criminals in what has long been known as “the kidnap capital of the world”. Some of the victims are politicians such as Ingrid Betancourt, held for six years by FARC guerrillas before being freed by the army last year. Most are ordinary citizens.

But is kidnapping as prevalent as many Colombians fear? The official figures show that 437 people were seized last year. That is down from 2,882 in 2002. Yet bizarrely, perhaps, a new study by the government of President Álvaro Uribe claims that there may be just 125 hostages still being held for ransom, be that pecuniary or political.

Officials from Fondelibertad, the government’s anti-kidnap agency, have combed through the cases of the 3,307 kidnaps since 1996 that are officially still unresolved. They found that 507 of these victims had been freed or had died. A further 1,173 people were found not to be in captivity, either because they were freed and never told authorities, or because they had not in fact been kidnapped. By trawling through financial, medical and telephone records the researchers found that some people who were presumed still to be in captivity had recently opened bank accounts, had medical exams or acquired a mobile phone line. Three people on the kidnap list had later spent time in prison. In the remaining 1,502 cases there was insufficient information.

Of the 125 confirmed hostages, 66 are being held by the FARC. They include 22 soldiers and police whom the guerrillas want to swap for government concessions. In a recent statement, the FARC said that, apart from the “swappable” hostages, it is holding nine others for ransom. It said it will release an army corporal held for 11 years whose father has walked across Colombia in chains to plead for his release. Ten other hostages are being held by a second guerrilla outfit, the ELN. The remaining 49 were abducted by common criminals or by newly organised paramilitary gangs.

For many activists who work with the families of hostages, the government’s numbers are absurdly low. Fundación País Libre (Foundation for a Free Country), an NGO, says that its records suggest that 1,617 people kidnapped between 2000 and 2008 remain in captivity. The foundation is working with the families of dozens of people kidnapped by the ELN, and hundreds seized by the FARC. Fewer people are kidnapped in Colombia than a decade ago. But it is reasonable to conclude that many cases continue to go unreported. It seems wildly premature to conclude that this plague has been all but wiped out.

Sri Lanka's war

Dark victory

Apr 23rd 2009 | COLOMBO
From The Economist print edition

But the imminent end of war offers an historic chance to make peace

Reuters

A DARK herd creeps across a grassy plain, wades a shallow lagoon and clambers to safety. Filmed from the air on April 20th, this was a scene Sri Lanka's government had been dreaming of: the start of a mass breakout from the Tamil Tigers' last sanctuary by, it claims, over 100,000 refugees—perhaps two-thirds of those being held hostage there. Having inspired the exodus, by breaching a sandy embankment around this "refuge", a few kilometres of beach in north-eastern Sri Lanka, the army has encircled the surviving Tigers.

According to its private estimate, the Tigers may be reduced to 1,000 hardened fighters, plus a few thousand recently impressed refugees. The army believes Velupillai Prabhakaran, the Tiger chief, and his senior henchmen are among them—as was also claimed this week by a spokesman for the Liberation Tigers of Tamil Eelam (LTTE), as the rebels are properly known, after the Eelam, or Tamil homeland, for which they have waged a 26-year war. To bag these men, the last prize of a brutal two-year offensive, the army claims to be using stealthy tactics, with "deep-penetration" commandos and snipers. It has a history of over-egging its battlefield triumphs. But the government of President Mahinda Rajapaksa seems genuinely to believe that one of Asia's oldest wars could be over within days.

That would be momentous, and the island-nation's Sinhalese majority will rush to celebrate it—and perhaps also give Mr Rajapaksa victory in an important regional election, in Western Province, on April 25th. Sri Lanka's long war has probably cost over 100,000 lives, including 30,000 in the past two years.

Coinciding with a period of high economic growth outside the war-zone, in the west and south, the conflict has come to seem an increasingly anachronistic blot on a hopeful country. By rallying Sinhalese, who make up around three-quarters of the population, to support an all-out campaign against the Tigers, which his steely defence chief and brother, Gotabhaya Rajapaksa, and General Sarath Fonseka, the army commander, have ably delivered, Mr Rajapaksa has almost erased this stain. Nor should Mr Prabhakaran and his crew be mourned. A well-organised and vicious terrorist group, expert in brainwashing and suicide-blasting, the LTTE has maintained its fief—which until late 2006 extended over almost a third of the country—by murder and fear. Moreover, having sabotaged a peace initiative of the previous government, and helped it lose an election by imposing a boycott on Tamil voters under its sway, Mr Prabhakaran has had the war he was asking for.

Yet, among Tamils, who may represent 18% of Sri Lanka's population, including a community descended from 19th-century Indian immigrants which has played little part in the war, Mr Rajapaksa's impending declaration of victory will be largely derided. And the congratulations of many foreign governments, especially Western ones, will be muted. The main reason is that the government's apparent victory has come at an appalling cost. Hillary Clinton, America's secretary of state, said this week that the entire world was disappointed that in its efforts to end the war, it was causing "such untold suffering".

In its rush to exterminate the Tigers—partly in justified fear of their skill at manipulating foreign opinion—the army has shown a cruel disregard for Tamil civilians crowding the battlefield. Earlier this month the UN estimated that since early January, when the Tigers' fled their northern capital, Kilinochchi, driving perhaps 200,000 civilians before them, some 4,500 had been killed and 12,000 wounded. The International Committee of the Red Cross, which has evacuated over 10,000 wounded civilians and their relatives from the no-fire zone, said on April 20th that hundreds more had been killed or wounded since the army made its breach.

Most appear to have been victims of shellfire inside the Tigers' last refuge, though the government designated it a "no-fire zone" and claims to have shelled it only when civilians would not be harmed. It accuses the Tigers of bombarding the zone, to bolster international demands for a humanitarian ceasefire. But entrapped civilians, including doctors manning a makeshift hospital on the northern tip of the zone, say the army is to blame; and human-rights researchers believe them. More broadly, the government's campaign has been marked by gross disregard for the rule of law, especially as it applies to Tamils. The defection in 2004 of a senior LTTE commander known as "Karuna", now minister for national integration and reconciliation, enabled the army to capture the east rapidly, by mid-2007. Unfazed by the crimes allegedly committed by its proxy, including the forcible recruitment of children and many murders, the government has partly emulated them. In the east and elsewhere, especially Colombo, the country's main city, it is alleged to have abducted and killed hundreds of young Tamils. Nor are Sinhalese entirely safe, especially journalists. Several have been mysteriously assassinated, and the rest terrorised. Reporters Without Borders, an NGO, considers Sri Lanka more hostile for journalists than any other democracy.

Asked whether he could not have prosecuted a just war more justly, Gotabhaya Rajapaksa, the defence chief, says the government had no choice but to use extraordinary tactics against a monstrous foe. Mr Rajapaksa denied they included extra-judicial killing. But he admitted that many Tamils had been detained and interrogated for extended periods. Most, he claimed, were operating as LTTE agents under false identities. "You can't expect all the normal things that happen in a normal society because the LTTE are not like that."

The American example

If this recalls the defence of water-boarding and other brutalities offered by America's former government, it should. A former Sri Lankan army colonel, Gotabhaya Rajapaksa is also an American citizen; and the government has often likened its war against the LTTE to America's zero-tolerance of Islamist terrorists. To an extent, America and its Western allies have encouraged the comparison, by proscribing the Tigers as a terrorist group. Yet the Western powers, which face no threat from the LTTE and whose politicians are susceptible to skilful lobbying by the expatriate Sri Lankan Tamils who bankroll it, have extended their sympathy only so far. They have lambasted the government for its human-rights abuses and, in the case of the EU, Sri Lanka's biggest export market, threatened to cancel preferential trade terms. Making matters worse, the government has used such criticism, levelled, it claims, by Tiger-hugging imperialists, to stir up Sinhalese nationalism. This has hardened domestic support for the war, but alienated Sri Lanka's foreign allies.

As a result, Sri Lanka, one of Asia's oldest democracies, has been driven to seek other friends: Pakistan, its main arms-supplier; Iran, which has been providing 70% of its oil supply on tick; and Libya, from which it expects a soft loan of $500m to arrive soon. That cash would be welcome, but insufficient to avert a looming solvency crisis. The government's profligacy, including defence spending that has ballooned as the army's strength has been doubled within three years, to 200,000, has depleted the country's foreign-currency reserves, which now cover barely six weeks of imports. The president, who is also the finance minister, this week dispatched emissaries to the IMF to negotiate terms for a $1.9 billion loan.

Undoing the damage its campaign has done to Sri Lanka's economy, reputation and democratic institutions will take years. But the government's abuses against Tamils may prove even costlier. Annihilating the LTTE will work only if, as the government claims, they do not represent the aspirations of their marginalised community. But its ethnically-guided "control measures", in Gotabhaya Rajapaksa's phrase, have suggested to many innocent

Tamils that the government considers them terrorists. The internment of almost every resident of Mr Prabhakaran's former northern fief, including some 70,000 before this week's flood, provides a relatively mild, yet pressing, example of this.

Given that many of these people have grown up under the LTTE, the government obviously must vet them. It also reasonably notes that their mine-strewn paddy-fields may be unsafe for some time. Yet the government's original plan, to keep this population penned up for a year or more, was outrageous. In a rare concession to its critics, the government has somewhat relented: it now aims to resettle 20% of the interns by the end of this month and 80% by the end of the year. Yet to members of a proud minority, almost without exception, such blundering confirms the government as just the sort of diehard Sinhalese overlord that drove the LTTE to take up arms in the first place. And indeed, some members of Mr Rajapaksa's regime, including General Fonseka, are avowed Sinhalese chauvinists. So even moderate Tamils, their ranks severely thinned by LTTE assassins, say they will be worse off without Mr Prabhakaran as their champion. Echoing the LTTE's propagandists, a retired Tamil judge, an otherwise sensible pundit, accuses the government of genocide.

Winning the peace

For Mr Rajapaksa to win over many Tamils would be tough. Yet if he is to turn military triumph into enduring peace, he must try. And in some ways, he has an historic opportunity to succeed. Crowned with laurels, he is expected to hold parliamentary and presidential elections within a year, and win thumping majorities in both. That would give him—and his three brothers with ministerial status—unprecedented power to transform Sri Lanka. Having removed the obstructive LTTE, or (remembering the restorative powers of the Tamil diaspora) at least crippled it, Mr Rajapaksa could preside over the emergence of a liberal Tamil polity. By implementing a policy of regional devolution, that has existed on the statute for two decades but never in fact, he would go a long way to meeting the basic political demand of most Tamils. Such steps would win Mr Rajapaksa global acclaim. Yet there seems worryingly little chance he will take them.

As in the east, the government says it will quickly hold an election in the north for a provincial government. It also promises massive infrastructural development in the region. Yet Eastern Province is an unconvincing blueprint for healing Sri Lanka. Its election, won by a coalition led by Minister Karuna's mob, was tainted by allegations of voter intimidation. Under the chief-ministership of Sivanesathurai Chandrakanthan, a former LTTE child-soldier and comrade of Minister Karuna (with whom he is now at war), it remains worryingly violent. According to the International Crisis Group, which this month released a discouraging report on progress in the east, Mr Chandrakanthan's administration has minimal power.

Nor should the north count on even this modest reform. In the absence of a powerful local proxy, the government is mulling having another of its controversial Tamil allies, Douglas Devananda, elected as its chief minister. This might be difficult. Mr Devananda, the minister for social welfare, is said to be loathed in Jaffna, the capital of Northern Province. But if he, or some other enemy of the LTTE, cannot be assured of victory, Gotabhaya Rajapaksa says the election may not be held. Despite the supposed liberation of the region from the terrorists' yoke the authorities seem strangely worried that northerners may yet vote in a pro-LTTE government.

China's navy

Distant horizons

Apr 23rd 2009 | QINGDAO
From The Economist print edition

If you've got muscle, flaunt it

WITH an unprecedented display of its rapidly growing naval armoury, China has flaunted its ambitions as a global power. To mark the 60th anniversary of the founding of the People's Liberation Army Navy (PLAN), Chinese leaders on April 23rd reviewed a maritime parade of hardware ranging from nuclear submarines to amphibious assault-craft and fighter bombers. The only missing ingredient of naval might was an aircraft-carrier. Officials hint it will not be long before China has some of these too.

Ten years ago, the PLAN's 50th anniversary slipped by with little more than a few commemorative stamps and plenty of bunting. But the last decade has seen the fruits of a huge military modernisation and expansion programme, launched after tensions mounted in the Taiwan Strait in 1995 and 1996. This has included the purchase of billions of dollars worth of Russian naval hardware, and the deployment of homemade ships, submarines and missiles. The build-up has sent ripples of unease across China's neighbourhood.

China was anxious lest the parade, in the port city of Qingdao, sent too scary a message. It invited foreign navies to take part too, including America's 7th Fleet, which sent a guided-missile destroyer, the USS *Fitzgerald*. The official theme of the show was "harmonious ocean". China's neighbours wish it were so. China disputes its sea borders with several countries, most heatedly with Japan, Vietnam and the Philippines. Of the five floating vessels at Qingdao's naval history museum, two were involved in the sinking of a Vietnamese ship during a skirmish in the South China Sea in 1988.

The deployment of two American aircraft-carriers near Taiwan during a crisis in relations in 1996 troubled China's leaders. Its military build-up, including the naval expansion, seemed primarily aimed at deterring any future American intervention over Taiwan. In the past few years, cross-strait tensions have eased, most markedly since the election last year of a more China-friendly Taiwanese president, Ma Ying-jeou. But the huge increase in its demand for foreign oil and other resources means China is now thinking more about how to protect its more distant supply lines.

As it happens, these lines traverse the disputed South China Sea, almost all of which China claims, but where it has lacked the ability to project naval power. China is coy about its naval strategy, but in March the Pentagon's annual report on China's military capability argued it could be trying to develop the ability to "hold surface ships at risk" out to a second island chain (see map), far beyond the first chain, which encompasses claimed offshore territories including the South China Sea. The second chain reaches Guam, where America has a big military presence.

Some of the new weaponry on display in Qingdao suggested that projecting power is becoming a bigger priority for China. Among the vessels inspected by President Hu Jintao from on board a Chinese-made destroyer were two nuclear-powered submarines. China's official press identified them as a Xia-class ballistic-missile submarine and a Han-class attack submarine. These are not China's very latest models, but showing them at all was rare.

China is coy about its submarines. Foreign military officials attending the regatta toured a Song-class diesel-electric submarine. The Song has been in use since the 1990s, but it was the first time that some of these officials, despite repeated requests, had been allowed inside one. China has said nothing about its new Jin-class submarines armed with long-range nuclear missiles. The Pentagon reported that the first of these had been deployed.

The Qingdao review did include an interesting addition to China's fleet, a Yuzhao-class amphibious-assault ship, which could be used to dispatch troops and helicopters over long distances. One Western diplomat says he sees its deployment as potentially useful for settling scores in the South China Sea. The contrast between the display of such weaponry and China's rhetoric about harmony he calls "a bit of schizophrenia". China's self-image as a responsible great power was also on show, however, with a large new hospital ship, useful for humanitarian missions. Three vessels have just completed an anti-piracy tour in the Gulf of Aden. This continuing mission is China's first active naval deployment beyond the Pacific.

Source: The Pentagon

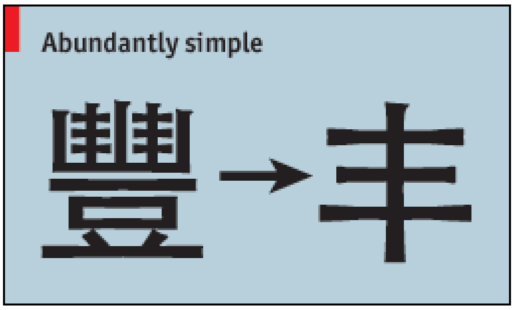
Chinese leaders chose not to spoil the jolly mood in Qingdao by talking about aircraft carriers. But officials have dropped several recent hints that China is close to announcing it will acquire its first one. Admiral Gary Roughead, the American navy's highest-ranking officer, told reporters in Qingdao that "it may cause concern" among navies in the region if China failed to make clear how it planned to use a carrier. But since such a ship would be of limited use in coastal defence, coming clean might cause even more concern.

Chinese script

Not as easy as it looks

Apr 23rd 2009 | BEIJING
From The Economist print edition

A character-forming development



FOR better or worse, Mao Zedong usually came out on top, whether facing Japanese invaders, nationalist warlords or Communist Party rivals. But for all his success in overturning traditional values and institutions, the founder of modern China came up short in his desire to convert written Chinese from its character-based system to an alphabet. Intellectuals resisted fiercely, some out of the belief that China's writing system was superior to any other, and unified a land of many dialects far better than a phonetic system, others on simple sentimental grounds.

Many claimed it could not be done, despite the examples of Korea, which managed the trick in the 15th century, and Vietnam which, like China, has a tonal language with many homonyms but switched successfully to an alphabetic system. In the end Mao settled on a halfway step: cutting the number of strokes in some Chinese characters (from 18 to four in the case of *feng*, which means "abundant", and is shown above). This set China apart from Hong Kong, Taiwan and most overseas communities. Many purists thought simplifying characters as appalling as eliminating them.

That fierce debate is now being rekindled with the government's announcement of plans to issue later this year a new list of character modifications, aimed mainly at correcting certain "oversimplifications" undertaken in the past. Some characters will have more strokes added and thus be brought closer to their earlier, more complicated forms. But officials insist the move does not mark the start of a campaign to scrap simplified characters. China, they say, need not move back toward the traditional forms, nor further along the path of simplification. It simply needs to "standardise" things.

This will disappoint Pan Qinglin, a member of the consultative committee that advises China's government. In March he submitted a proposal to the government calling for a return within ten years to the greater expressiveness and "artistic quality" of the traditional script. Others, however, will be pleased, including the internet commentator who recently compared reviving traditional characters to "asking women to revive the practice of foot-binding".

Other arguments focus less on deep issues of cultural identity than on practical concerns, such as how hard the new forms will be to learn, how much it will cost to convert signs, replace textbooks and adapt software, and whether the government will pay for the changes. Mao famously argued that "revolution is not a dinner party, or writing an essay, or painting a picture". It might, however, be reforming orthography.

Cambodia, Kuwait and farmland

Petrodollars v smallholders

Apr 23rd 2009 | BATTAMBANG
From The Economist print edition

Disputes erupt over plans to invest millions in rice farming

IT SEEMED like the perfect match. Kuwait has a lot of money and needs to import food. Cambodia has a lot of fertile land and wants to attract foreign capital. So, as has been happening around the world since the food-price spike of 2007-08, the government of a poor farming country is planning to hand over vast tracts of land to a richer, oil-producing one.

In a whirlwind courtship, Cambodia and Kuwait have exchanged prime ministerial visits and initialled deals on everything from opening embassies and boosting energy co-operation to opening direct flights and holding football friendlies. Kuwait has now reportedly agreed to offer loans totalling $546m to finance a dam on the Stueng Sen river for irrigation and hydropower and to build a road to the Thai border. The Cambodian government says it has not yet decided what exactly the Kuwaitis will get in return but the speculation in Phnom Penh is that they may be offered 50,000 hectares (124,000 acres) of farmland, possibly on 99-year leases. Kuwait is not alone. Last year the prime minister of another rich Gulf statelet, Qatar, also visited Phnom Penh, with plans to invest $200m in Cambodian agriculture.

Such deals have a way of turning sour because of disputes over details. The Cambodian one seems to be conforming to type. Agreements ratified by the rubber-stamp parliament contain sweeping generalities and less detail than most people would expect when they rent an apartment. Son Chhay, an opposition MP and chairman of the National Assembly’s foreign-affairs committee when the deals were initialled, said he could not now obtain copies. But if foreigners want Cambodian rice, he says, they should buy it, not seek to control vast tracts of land.

The other problem with such deals is that they are made in national capitals and often run into opposition on the ground. Cambodia’s rice-farmers are suspicious enough because the government has a record of throwing them off their land in opaque deals involving rich cronies. Villagers in Battambang province, where the Kuwaiti road will run, say they know almost nothing about the scheme. They concede that a new road, built on what is currently a dirt track being measured by surveyors, would help them get crops to market. And according to one happy rumour, Kuwait has agreed to buy all their produce. But they are worried that their land will be confiscated—as has happened before.

The government insists the deal would be good for the country and for economic growth. Cheam Yeap, the chairman of the parliamentary economics and finance committee, says that “somehow we have to attract investors for national development.” He argues that land conflict is the fault of farmers as well as the government and that farmers have to be realistic.

This is not merely self-serving. Cambodia’s rice yields are about half those in neighbouring Thailand and Vietnam. Many people—not just the Kuwaitis—are seeking to modernise farming, which is the largest employer in Cambodia.

International donors are hoping to improve the lot of small-scale farmers by helping them take advantage of world markets by investing in productivity, food processing and transport infrastructure. Other international businessmen, including some from Israel, are seeking to bring foreign technology and capital into Cambodia’s fledgling agri-business sector.

So the question is not whether investment by Kuwait or anyone else is in Cambodia’s long-term interest.

It is whether the terms of the particular deal are beneficial. Alas, it is far from clear in this case whether Cambodia's rulers have been influenced by economic development—or by the prospect of another quick payday.

Vietnam and China

Bauxite bashers

Apr 23rd 2009
From The Economist print edition

The government chooses economic growth over xenophobia and greenery

AP

General Giap fights another battle

IN A one-party state where people are routinely jailed for criticising government policy, it is rare for all but the most brave or foolhardy to speak out. But a government plan to allow a Chinese company to start mining some of the massive reserves of bauxite lying beneath Vietnam's verdant Central Highlands has provoked an unprecedented backlash from an unlikely assortment of critics. They include a nonagenarian war-hero, Vo Nguyen Giap, a dissident monk, Thich Quang Do, and a slew of leading scientists and environmental campaigners.

Vietnam is blessed with the world's third-largest reserves of bauxite, the raw material for aluminium, and the communist government is keen to reap the benefits. Under a plan that the prime minister, Nguyen Tan Dung, has called "a major policy of the party and the state", the government is seeking to attract $15 billion or more of investment to develop bauxite mining and aluminium refining projects by 2025. It has already signed a contract with a subsidiary of Chinalco, a state-owned Chinese mining group, to build one mine and agreed with Alcoa, an American aluminium giant, to carry out a feasibility study for another.

Critics say the arrival of large-scale bauxite mining in a region that currently grows coffee and other crops could cause irreparable damage to the environment and displace the ethnic-minority groups who inhabit the Central Highlands. Bauxite is usually extracted through open-cast mines, which leave vast scars on the landscape. The process by which it is refined also produces a toxic "red sludge", which can cause serious pollution if it washes into streams and rivers.

As if that were not enough, the involvement of a Chinese company in such a controversial project has rekindled latent anti-Chinese sentiment in Vietnam, which was colonised by its larger neighbour for 1,000 years and fought a short but bloody war against it in 1979. Thich Quang Do, the leader of the outlawed Unified Buddhist Church, claims that Vietnam is "under threat of invasion" because "whole villages of Chinese workers have mushroomed on the plateau, and 10,000 Chinese settlers are expected in the coming year." His comments have been echoed by Vietnam's enthusiastic army of bloggers, and an anti-bauxite-mining group set up on Facebook, a popular social-networking website, has attracted nearly 700 members. Chinese bloggers are not, it seems, the only ones to resort to inflamed xenophobia. And though much of the opposition is no doubt driven by that feeling, there are also genuine concerns about the lousy environmental records of many Chinese mining companies.

Whatever the motive, however, the Vietnamese government is nervous about public criticism of China. It recently banned a bi-weekly newspaper called *Du lich* (Tourism) for three months for running a series of articles about territorial disputes between the two countries. The explanation is that China is Vietnam's biggest trading partner. Vietnam also runs a massive trade deficit with its neighbour and has been pushing China's government to invest more in the country to offset the deficit. With foreign direct investment 40% lower in the first quarter of 2009 than it was a year before—and most rich nations short of cash—Vietnam needs Chinese money now more than ever.

Much to the chagrin of the anti-China lobby, Mr Dung, the prime minister, spent a week this month touring China, trying to drum up investment and pledging to make it easier for Chinese companies to operate in his country. Following a meeting with China's prime minister, Wen Jiabao, Mr Dung said that the two countries would strive to expand bilateral trade from $20 billion in 2008 to $25 billion by 2010 and try to tackle the trade imbalance.

Hoang Trung Hai, a deputy prime minister, recently told a conference of scientists concerned about environmental damage that Vietnam will not pursue the bauxite mining plan “at any cost”. But the reality is that in straitened economic times, beggars cannot be choosers.

Australia and asylum-seekers

The burning deck

Apr 23rd 2009 | SYDNEY
From The Economist print edition

An old argument starts again

EPA

A new arrival sails into stormy waters

AT FIRST the fishing boat crammed with 47 asylum-seekers, mostly Afghans, seemed like similar vessels turning up lately in north-western Australia's waters. Then, on April 16th, it exploded. Three asylum-seekers drowned fleeing the inferno. Two are still missing. Together with another boat arrival on April 22nd, the drama has inflamed a political conflict on a subject many Australians thought they had put to rest: their tolerance for refugees escaping strife in countries to the north.

The explosion also posed the first test of the promise by Kevin Rudd, the Labor prime minister, of a more humane approach to refugees. Reports soon emerged of fuel being poured on deck. Speculation followed that the fire was either an accident, or sabotage by people alarmed that hovering Australian navy ships might send them back to Indonesia, where they embarked. Mr Rudd said such guesses compromised possible prosecutions of people smugglers. Earlier, he had called them "the lowest form of life". Police in the Northern Territory say their report on the case could take months.

Mr Rudd's main target, though, was a turbulent legacy left by John Howard, his conservative predecessor. Mr Howard exploited public anxiety about boat arrivals to help win an election in 2001. He and his ministers claimed asylum-seekers on one boat had thrown their children into the sea to intimidate the authorities. The claim was later proved false. The Rudd government has dropped two of Mr Howard's approaches: sending people to camps in Pacific island-nations while their asylum bids were assessed; and granting approved refugees restrictive, three-year visas.

Since the changes, the number of arriving boats has climbed: 14 in 2008-09 compared with three the previous year. But boat people comprised only a fraction of the 4,750 asylum applications Australia received last year, a small enough number compared with those in some other rich countries. In any case John Gibson, president of the Refugee Council of Australia, an NGO, argues the old temporary visas drew more, not fewer, boat people. He says many of the 353 people who drowned on one boat in October 2001 were Afghan and Iraqi women and children trying to reach men in Australia whose temporary visas shut their families out.

There are signs Australians' attitudes have softened since then. In an opinion poll on April 20th, 57% thought tougher policies would not deter boat people. Pictures of doctors treating 40-odd people from the blazing boat have humanised their plight. Much improved relations with Indonesia should promise stronger action against people smugglers. Indonesia agreed this week to extradite Hadi Ahmadi, whom Australia wants to prosecute for his alleged involvement in four boat arrivals involving 900 people in 2001.

Banyan

Calling Kim Jong Il's bluff

Apr 23rd 2009
From The Economist print edition

Even if North Korea refuses to rejoin six-party talks, they can still have a useful function

Illustration by M. Morgenstern

NUCLEAR blackmail is an old trick of Kim Jong Il, North Korea's 68-year-old dictator, learnt at the knee of his father, Kim Il Sung. Since April 5th, and the launching of what North Korea said was a satellite but the rest of the world reckons was a failed missile, he has been at it again. North Korea expelled United Nations inspectors from its ageing reactor complex at Yongbyon and now declares itself no longer bound by the six-party process involving South Korea, China, Japan, Russia and the United States that was meant to lead to abandonment of its nuclear-weapons programmes, in return for aid and respect. After days of wrangling over the launch, the UN Security Council delivered no more than a light knuckle-rapping.

Yet North Korea professes to be insulted. It threatens to rebuild Yongbyon and start making weapons-grade plutonium again. This week, after its first talks with the South in more than a year farcically broke down after just 22 minutes, it accused the South of "a vicious criminal act": the shifting of a border post. The chances of some sort of armed skirmish have risen.

So far, so consistent with North Korea's traditional belligerence. Back in 1994 Bill Clinton promised aid and two light-water civilian reactors in return for closing Yongbyon, yet Mr Kim started new nuclear work. Promising to be less gullible, George Bush listed North Korea in his "axis of evil". Mr Kim merely redoubled his nuclear efforts, exploding a device inside a mountain in October 2006, despite a 2005 agreement to denuclearise. Mr Bush's envoys suggested more talks. Having already sold Yongbyon twice, to both Mr Clinton and Mr Bush, Mr Kim presumably intends to sell it a third time, to Barack Obama.

Yet if the aim was to engage Mr Obama on Mr Kim's terms, it has backfired. That is partly because the launch failed, despite North Korea's claims that its satellite is beaming back chirpy revolutionary songs. This is its third long-distance missile test; all flops. Though North Korea's short- and medium-range missiles threaten South Korea and Japan, it is far from having a deterrent to any American nuclear attack. Its only nuclear explosion was thought a damp squib. Miniaturising nuclear warheads is hard, and the North has enough plutonium for just ten or so nuclear devices. Reprocessing the remaining spent fuel rods at Yongbyon would give it one more bomb. In this sense only, more nuclear tests would actually help, by using up what plutonium is left.

So North Korea remains a rogue state with an alarming nuclear programme rather than being a nuclear

power in its own right. Mr Obama's North Korean policy is unformulated, and his foreign-policy and security team incomplete. But the clearer the shortcomings of the North's nuclear programmes, the less Mr Obama will be inclined to rush like his predecessor into deals that quickly unravel. That will reassure South Korea and Japan, which despaired that Mr Bush's negotiations sometimes allowed North Korea to drive a wedge between America and its allies.

Mr Kim's belligerence has backfired in political terms too. In his inaugural address, Mr Obama said he would extend a hand to those willing to unclench their fist. He faces criticism at home for reaching out to Iran and for greeting Hugo Chávez, Venezuela's strongman. It would be too much of a gift to hardline Republicans if he also extended his hand to Mr Kim's clenched one. So the grand bilateral bargain that the Dear Leader has long wanted—aid, full recognition and security guarantees in return for giving up his box of nuclear tricks—remains as remote as ever. The North's oppressed and impoverished people are the victims.

What happens next depends in part on China, North Korea's ally. At the recent Bo'ao Forum, China's answer to Davos, on Hainan island, a string of Chinese policymakers shunned Deng Xiaoping's dictum that China should "keep a cool head, maintain a low profile and never take the lead", arguing instead for what amounted to a new world order, centred in Asia (read China). Some Western commentators divine a profound shift as China bids for the role of global hegemon.

If this claim can be tested anywhere, it is presumably in the six-party process, which China hosts. Yet here the claim falls short, and not only because China struggles to influence its small neighbour. China had as much reason as anyone, or more, for falling in with international condemnation of the rocket launch, as it did after North Korea's nuclear test. The provocation only raises the odds that America, Japan and South Korea will develop anti-missile defences that undermine China's own deterrence. Worse, an unrestrained North Korea might conceivably push Japan into going nuclear, as Japanese hawks are once again suggesting. Either path would mean a new regional security order even less of China's making than the current one.

Five can party, too

So it is in China's interests that the six-party talks continue, as they should: even without the North, their main object. This would signal that no one is in a hurry to re-engage with North Korea solely on its terms, but that the door is still open. More important, remaining members have much to get on with. The recent brouhaha may speak of internal tensions in North Korea. After a presumed stroke last year, Mr Kim looks physically half the man he used to be. For lack of any official pronouncements, rumours swirl about his succession.

The best outcome for most North Koreans must presumably be for the Kim regime to crumble, despite the risks that might follow, including huge refugee flows, civil war and quantities of weapons of mass destruction falling into the wrong hands. Yet contingency planning done collectively by the North's neighbours and the United States is almost nil. Here is a good purpose for the six-party forum. China, as a close neighbour, would be hugely affected by turmoil in North Korea. It has every reason to lead efforts in planning for it.

The new politics of Israel's foreign policy

A grand bargain?

Apr 23rd 2009 | JERUSALEM
From The Economist print edition

New governments in Israel and America could mean new ideas for peace in the Middle East

Illustration by David Simonds

ASKED about the hardy perennial of Palestinians and peace, officials in Israel's new government now reply with dire talk about Iran and the threat of nuclear war. “However much progress we might make on peace,” says one, “it would all disintegrate if Iran achieved the ability to make a bomb and proliferate it.”

That could be a diversionary tactic. After all, Binyamin Netanyahu, the new prime minister, spent much of his previous term in the job (1996-99) wriggling out of Israel's obligations under what was known as the Oslo peace process on various pretexts, to gratify his rightist-religious supporters. But it could also signal a readiness to consider a grand bargain: Iran defanged for Palestine decolonised.

Israelis and Americans, preparing for a first encounter between Mr Netanyahu and President Barack Obama next month, are increasingly focusing on the Iran-Palestine equation. Mr Obama's policy of trying to talk to Iran worries some Israeli policymakers. But there is also a growing awareness in Israel that the policy's chance of success, as well as the strength and effectiveness of Sunni Arab opposition to Shia Iran's nuclear ambitions, may hinge on America's ability to show progress on Israeli-Palestinian peacemaking.

That puts modest but unusual pressure on Mr Netanyahu from the Americans. Indeed, the Israelis may have to get used to being treated a little differently by Mr Obama's administration than they were by the previous one. For example, there had been plenty of indications that Mr Netanyahu might be visiting Mr Obama early in May, but the White House let it be known that the president was not available then. Jordan's King Abdullah, on the other hand, was hosted at the Obama White House on April 21st.

Peeved, Mr Netanyahu has embarked on a month-long “policy review”. This, his aides say, means he cannot answer for the moment such niggling questions as whether he accepts the very concept of a two-state solution to the Israeli-Palestinian conflict.

In his campaign for the election in February, he spoke of “economic peace” rather than full political peace between two proper states. While not endorsing the Palestinians' right to a state, earlier this month Mr Netanyahu told George Mitchell, the new American special envoy to the Middle East, that he would insist on explicit Palestinian recognition of Israel as a “Jewish state”. Mahmoud Abbas, head of the Palestinian

Authority, has been loth to make this pronouncement. Mr Netanyahu says it is not a precondition for talking, but it is a “fundamental condition” for reaching agreement. His aides explain that recognition of Israel’s Jewishness would imply a final renunciation of the claim to an unrestricted “right of return” for Palestinian refugees. Israelis, left and right alike, insist that any “return” must be severely limited—by Israel—in order to protect the Jewish majority and Jewish national character of their country.

President Obama and Mr Mitchell have carefully woven “Jewish state” into their own recent public statements. But the Americans have reportedly reacted coldly to this early demonstration of Israeli casuistic recalcitrance, finding it reminiscent of the pretext-finding and foot-dragging of Mr Netanyahu’s first administration.

This time, however, unlike then, Mr Netanyahu’s team is not of one ideological stripe. It includes the Labour party, with its leader, Ehud Barak, as minister of defence. Mr Netanyahu was determined to bring Mr Barak in, so as to escape the political and arithmetical thrall of his own hardliners. Mr Barak for his part, say insiders, is determined to vindicate his decision to join, bitterly criticised within his own party, by vigorously pushing for peace. A former prime minister from 1999 to 2001, who offered Israel’s boldest-yet concessions in an abortive negotiation for peace with the Palestinians brokered by President Bill Clinton, Mr Barak now advocates a “regional peace” effort.

Mr Barak does not need the spur of Iranian nuclear pretensions, say these insiders, to promote his peace agenda. But he assured Mr Mitchell that he is available to help persuade Mr Netanyahu of the merit of an Iranian bomb-for-Palestinian peace bargain.

This week, meanwhile, the Iranian connection loomed large and ugly, with President Mahmoud Ahmadinejad’s tirade against Israel at a UN conference on racism triggering a walkout of delegates (see article).

As bad luck or perverse planning would have it, the incident came just before a ceremony at the Yad Vashem memorial to the Jewish victims of the Holocaust in Jerusalem, on Holocaust Day. “We will not allow Holocaust deniers to carry out another holocaust against the Jewish people,” Mr Netanyahu said.

Mr Netanyahu’s officials say that Iran, because of the drop in oil prices and its consequent economic troubles, is now more than ever susceptible to international pressure to forgo its nuclear ambitions. He himself, more than any other Israeli politician, has harped since the mid-1990s on the threat to Israel of an Iranian bomb. Might that make him especially susceptible, despite his tough talk on the Palestinians, to American-led diplomacy that would seek to wrap Iran and Palestine in a grand regional peace bargain? Mr Obama and his advisers will be wondering as they brace themselves for a bout of Middle East diplomacy.

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Lebanon

Bucking the trend

Apr 23rd 2009 | BEIRUT
From The Economist print edition

A surprising economic success amid the usual political gridlock

LIKE shame-faced bankers the world over, managers at the Banque du Liban, Lebanon’s central bank, have had to admit that their initial figures for last year were wrong. But while number crunchers elsewhere toil to trim over-optimistic estimates into punier real results, statisticians at the Banque du Liban are revising theirs sharply upwards. Lebanon’s GDP grew during 2008, not at an annual rate of 7.5%, it seems, but at 9% or better.

Yet even that trend-bucking number looks modest compared to other milestones scored by this small, almost comically turbulent country. Last year the value of deposits in Lebanese commercial banks rose by 15% to an impressive $94 billion, equal to 327% of GDP. Industrial exports surged 24%. Tax revenues, tourist arrivals, banking profits and the number of construction permits all soared by a third or more. A giant 46% leap in net capital inflows helped Lebanon post a record $3.5 billion surplus in its balance of payments, and boosted the Banque du Liban’s own reserves to a cosy $22 billion, nearly double its holdings a year ago.

Nor does this upswing show much sign of slowing. Sales of new cars are up by 19%, and the number of tourists arriving in the country in the first three months of this year increased by 50% compared with the same period last year. Property prices are holding the past few years’ heady gains, and worries that the global recession would force home thousands of Lebanese expatriates, slashing the remittances that underpin the economy, have so far proven unfounded.

This all seems odd for a country with few natural resources, and which in the past few decades has endured a long and bloody civil war, devastating Israeli attacks, and a suspected campaign of assassination and destabilisation carried out by its only other neighbour, Syria. Consider also the coexistence of 17 sectarian groups, several of them boasting multiple armed militias, and the extreme polarisation of Lebanese politics into two bitterly opposed alliances that fought bloody street battles just a year ago, and the picture is more puzzling still.

Furthermore, all these opposing factions face national elections in just over a month’s time, yet no one seems particularly worried. This, say Lebanese with a shrug, is because of two things. Outside powers that love to meddle here, such as Saudi Arabia and Syria, are tired of bickering for now. And local politics have reached such a logjam that nothing much is likely to change. Whoever tops the polls in June will do so by a slim margin, leaving each factional alliance capable of holding the other in check.

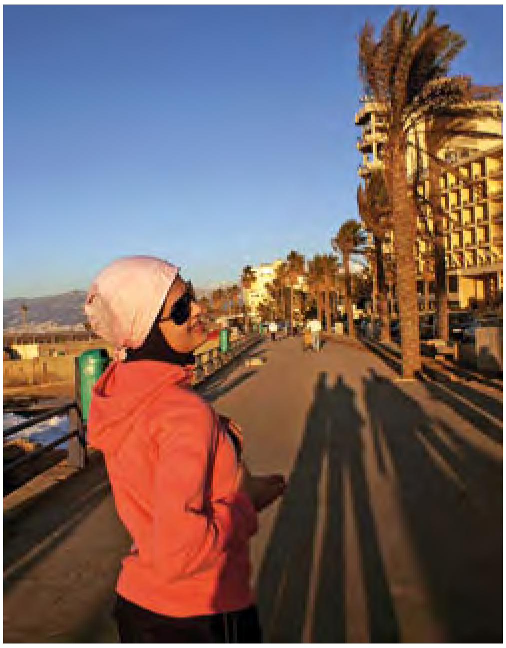
eyevine

But these factors go only part of the way to explain Lebanon’s unwonted success. The ironic truth is that the country’s double curse, of chaotic internal politics and being located in a nasty neighbourhood, are proving helpful for a change. For one thing, they have made Lebanese bankers unusually wary and resourceful. Four years ago, for instance, the Banque du Liban’s stern and far-sighted head, Riad Salameh, banned any dealing in such tricky foreign instruments as mortgage-linked securities. And while banks, property developers and service vendors raked in business as private cash spilled out of the oil-enriched Gulf, competition between influence-seeking powers brought a windfall in aid for reconstruction following the ruinous 2006 war with Israel. Iran alone has injected perhaps $1 billion to rebuild the heavily bomb-damaged parts of Beirut run by its protégé militia, Hizbullah.

With global financial turmoil now shaking such upstart regional rivals as Dubai, Lebanon has looked increasingly attractive as a

haven. Falling oil prices have cast gloom over the Gulf, and may eventually staunch the inflow of its money. But for Lebanese, they have meant a welcome shrinking of bills for imported energy.

All this relative rosiness could lead to complacency. This is a luxury, however, that most Lebanese know they cannot afford. On top of its constant curses, Lebanon also bears the burden of a colossal national debt. This has now dropped, in relative terms, to a mere 162% of GDP, triple the world average. Bringing this into more reasonable bounds will require not just wary resourcefulness, but actual leadership of a kind that the Banque du Liban alone cannot deliver.



The credit crunch, Beirut-style

Kenya's crumbling government

The great rift

Apr 23rd 2009 | NAIROBI
From The Economist print edition

Only greed and pressure from abroad now bind the ruling politicians together

AFTER the horrendous violence that followed Kenya's flawed general election in 2007, the mediation of Kofi Annan, a former secretary-general of the United Nations, was acclaimed for pushing the two main political parties into a coalition government. This at least stopped the bloodshed. Now, however, the deal is unravelling—fast. At a recent summit feuding government ministers could not even agree on what to discuss in order to find common ground. The Orange Democratic Movement (ODM) of the prime minister, Raila Odinga, stomped out before the meeting had even begun, accusing President Mwai Kibaki's Party of National Unity (PNU) of blocking the agenda.

Among the foreign diplomats looking on, optimists refer to the squabbling coalition as an "unconsummated marriage". The less charitable say Kenya does not have a functioning executive at all, just an unholy alliance of fierce rivals. A schedule of constitutional, electoral, judicial, security, land and economic reforms was laid out in the original agreement between the two parties. A domestic tribunal to judge those responsible for the post-election mayhem was supposed to be set up and a truth commission established. Yet more than a year later the ODM and PNU have failed to agree on any of these issues.

New corruption scandals, confined to no party, are regularly revealed by Kenya's papers. With so many senior figures from the main parties co-opted into the government—which has 94 ministers and deputies, each earning over $15,000 a month—Kenya has become almost a one-party state. Ministers constantly squabble over pay, protocol, seniority and even who gets the best rooms at government get-togethers. The churches, NGOs and foreign diplomats are left to play the role of opposition, cajoling and threatening from the sidelines.

The infighting and bickering have also confounded hopes for measures to tackle the causes of the post-election violence, or even the country's increasing gang violence. For example, Mr Odinga backed calls for the resignation of the soldier turned chief of the police, Major-General Hussein Ali, after he had been heavily criticised by human-rights groups and the UN over the activities of police death-squads. But Mr Kibaki, who appointed Mr Ali, has refused to let him go, despite an agreement to have a civilian head of the police. This week clashes in central Kenya between villagers and gang members of a criminal sect known as the Mungiki, who belong to the Kikuyu group, Kenya's biggest, left another 40 or so people dead.

Parliament reconvened this week. The next elections are not due until 2012, but so grave is the impasse that politicians are already attending to their political futures rather than present troubles. Martha Karua, who resigned as justice minister on April 6th in protest at Mr Kibaki's decision to appoint judges without consulting her, has said she will run for president. She gives press interviews, addresses crowds and lambasts the government she so recently abandoned as if a national poll were due for next week. Ms Karua is popular because she gives voice to the disgust felt by ordinary Kenyans towards their politicians. Her resignation is seen as a rare display of principle.

Unfortunately for Kenya, all that holds the coalition together now is mutual greed and pressure from abroad. Despite everything, foreign donor governments are nonetheless determined that the coalition should not collapse entirely. They believe any government is better than none, fearing yet more violence.

Mr Annan may intervene again. Within a few months, unless the domestic courts deal with the matter properly, he promises to hand over to the International Criminal Court the names of ten people considered by a special Kenyan commission to be responsible for the post-election violence. The removal of these figures from Kenya's politics, and even from the cabinet itself, might give a useful jolt to the country's dysfunctional political system.

South Africa's election

Zuma cum laude?

Apr 23rd 2009 | JOHANNESBURG
From The Economist print edition

The difference between winning and winning big

AS EXPECTED, the African National Congress (ANC) romped home to its fourth successive victory in national and local elections on April 22nd. With nearly a third of the votes counted as *The Economist* went to press, the ANC was being given around 65% of the vote, just short of the two-thirds majority it had hoped to win. The Democratic Alliance (DA) produced the biggest surprise, bagging around 18%, well up from its 12% score in 2004. The Congress of the People (Cope), the new ANC breakaway party, got less than 10%.

With the emergence of what was deemed to be the first serious black-led challenge to the monolithic ruling party, the turnout was expected to be high for what was regarded as South Africa's most important election since the first fully democratic elections in 1994. In many areas, polling stations were allowed to remain open until midnight, three hours after they were supposed to close, in order to allow those who had been waiting, often for several hours, to cast their vote. Some stations even ran out of ballot papers, though this seems to have been caused by mistakes in the distribution rather than any real shortages.

In the end, however, the turnout appears to have been about the same as in 2004, 77%. That is high by Western standards, but sharply down on the 89% in 1999, and the even higher figure recorded in the 1994 election.

The biggest lesson to be drawn from the early results is that Cope, which so many South Africans had hoped would turn into a viable alternative to the all-powerful ANC, has done worse than most people thought it would. It may now fizzle out. From the outset, it was handicapped by its close association with the scandals and flaws of the ruling party from which it emerged, and with the deeply unpopular Thabo Mbeki, who had been forced to step down as South Africa's president last September by Jacob Zuma and his allies.

Cope also suffered from all the other disadvantages that beset any brand new party; it had little funding and almost no structures. But it also created its own problems with the bitter infighting between its leaders and the late appointment of a political unknown, Bishop Mvume Dandala, as its compromise presidential candidate. Other than promising to root out the corruption and nepotism endemic in the ruling party, which all opposition parties and even the ANC itself promised to do as well, Cope seemed to have no clear profile.

EPA

The DA, on the other hand, fought an excellent campaign, led by its impressive leader, Helen Zille, a former journalist and mayor of Cape Town. If, as looked likely, the DA gets the biggest share of the votes in the Western Cape (of which Cape Town is the capital), she will take over as the only non-ANC premier in South Africa's nine provinces. The party still suffers from its image as a predominantly white, middle-class party, but it comes over as a serious and intelligent outfit, with well thought-out, achievable policies. If it and Cope agreed to join forces, they could still mount a credible opposition to the ANC.

The ANC, meanwhile, has lost a little support, but not nearly as much as some had hoped, and others had feared, when Cope was first set up. The ruling party, too, fought an excellent campaign, led by its ebullient, seemingly tireless 67-year-old leader, Mr Zuma. In the end, despite all the grumbling, ANC supporters appeared to care little about his polygamy, his brushes with the law, or any of the scandals which have rocked the party. For the

vast majority of black South Africans (representing 80% of the total population), the ANC remains more than just a party. It is their home. That is why they have given it another five years in power.

Mr Zuma should be elected president by MPs at the first session of the new parliament on May 6th. No one is yet sure what kind of leader he will be. During the campaign, he sought to be all things to all men, so South Africans will have to wait a little longer to be able to judge the direction in which he is taking them. Along the road to a mature multi-party democracy? Or down the path of other failed, post-liberation African states?

Patient democrats

Ukraine's troubles

The Viktor and Yulia show, continued

Apr 23rd 2009 | KIEV
From The Economist print edition

The squabbling "orange revolution" leaders are failing to push through the longer-term reforms that the economy needs

AFP

A COUNTRY in default, engulfed by social protests and political chaos, crumbling to bits. This has been the West's nightmare image of Ukraine. It was the first country to ask the IMF for a bail-out, its currency was in free fall, its economy is contracting at an annual rate of 9%. Yet the main activity in Kiev today seems to be putting up summer terraces outside cafés, not tents for demonstrators. In front of the main government building, a dozen bored protesters call on Yulia Tymoshenko, the prime minister, to come out "to the people". Even in the industrial east, where output has fallen by as much as a third, the mood is subdued.

One reason is that trust in the government is so low and the experience of crisis so extensive that Ukrainians see little point in taking to the streets. At a time of hardship, working on a vegetable patch is preferable. A protest called by Viktor Yanukovich, leader of the opposition Party of the Regions, attracted relatively few people. There is no money to pay demonstrators. Stirring up his eastern heartland could annoy Mr Yanukovich's business backers, who have been cutting jobs and wages.

Another reason for relative calm is that after several years of growth many Ukrainians have enough savings to get by for a few months. Some unemployment has been avoided by involuntary holidays and pay cuts. And though the main exporting industry, steel, is struggling, farming (which employs a quarter of the workforce) is doing well. Petro Poroshenko, a businessman, suggests that food production could become an engine of growth.

"Either the country is more resilient or the adjustment started earlier than we thought," says Ceyla Pazarbasioglu, head of the IMF mission visiting Kiev. After a 40% devaluation, the hryvnia has stabilised. The trade balance went briefly into surplus for the first time in years. The rate of economic decline has slowed. "There is a feeling that we have touched the bottom," Viktor Yushchenko, Ukraine's president, says in an interview. On April 17th the IMF mission said it would recommend the release of the second tranche of Ukraine's $16.4 billion loan.

The banks have undergone a stress test and the biggest will be recapitalised. For all the political cacophony, the government has pushed through the fiscal measures required by the IMF, including

increased duties on alcohol and tobacco and higher gas tariffs for rich households. In the short term, Ukraine needs to cut its budget deficit. In the longer term its big problem is the structure of public spending rather than low tax revenues, argues Pablo Saavedra, an economist at the World Bank. Its unreformed social system and its red tape, both inherited from Soviet days, are crushing burdens. Ukraine devotes a third of GDP to social spending. Less than 2% of GDP goes to infrastructure investment. It takes 47 permits to open a business and three years to close it. All Ukrainian politicians, including Ms Tymoshenko, Mr Yanukovich and Mr Yushchenko, admit to corruption and lack of structural reforms in Ukraine—and blame each other. “We have been engaged with elections rather than with reforms,” says Anatoly Kinakh, who has served in several governments.

Now Ukraine is in the middle of a new election cycle. Mr Yushchenko’s presidential term expires in January and the campaign is under way. Political turmoil is nothing new in Ukraine, but when commodity prices were high and foreign credit cheap it had little impact on the economy. No longer. Ukraine nearly botched its agreement with the IMF partly because some members of Mr Yushchenko’s Our Ukraine block refused to vote for fiscal cuts. Mr Yushchenko says that “half of my own block has been bought by Ms Tymoshenko, while the other half cannot support her economic methods”. He blames Ms Tymoshenko for sacrificing the ideology of the 2004 orange revolution to political expediency and populism. She says that he has sold out to vested interests.

Mr Yushchenko certainly has ideology and vision. He talks of building a nation-state and taking Ukraine into NATO and the European Union. “Six times in the 20th century we have declared our independence and five times we have lost it.” Yet on vision, rhetorically at least, there is little difference between Ukrainian politicians. Ms Tymoshenko talks eloquently of European integration and the need to consolidate a country historically divided between east and west. “First of all we need to build Europe in Ukraine, because a country can only enter the EU if it has the same blood group, otherwise it will get rejected as an alien body,” she says in an interview. Even Mr Yanukovich, once backed by Moscow, now subscribes to the notion of European integration.

In truth, none of Ukraine’s politicians has risen to the promise of the orange revolution. Ms Tymoshenko’s actions sometimes smack of populism. When inflation rose last year, she imposed temporary controls on grain exports, for example. She has done little to promote long-term reforms. But it was thanks to her intervention both that the IMF loan was unblocked and that a breakthrough was made in the gas-price stalemate with Russia in January. In contrast, Mr Yushchenko’s influence has been mostly disruptive despite his avowed liberalism. He has vetoed many government plans, including privatisations.

The problem goes deeper than animosity between two old allies. It is rooted in a flawed change to the constitution in 2004 that reduced the power of the president but stopped short of turning Ukraine into a parliamentary republic, fudging the responsibilities of president and prime minister. “Whoever wins the presidential election will next day run into the same problems,” says Ms Tymoshenko.

Inevitably, all three main leaders insist they will run for president, including Mr Yushchenko, despite a poll rating in low single digits. But Ms Tymoshenko’s popularity has also suffered recently. Even Mr Yanukovich, who now leads in the polls, has seen his popularity dented. Many Ukrainians feel that none of the three familiar faces is capable of taking the country forward. Tired of the mudslinging, 20% would either vote against all candidates or simply not turn out.

To hedge their bets many businessmen are now betting on other candidates, including Arseniy Yatseniuk, a 34-year-old who has already served as foreign minister, economics minister and central-bank governor. Mr Yatseniuk’s rating has doubled in a few months and he is now catching up with Ms Tymoshenko. Her preferred option would be to change the constitution before the election and choose the next (symbolic) president in parliament. But she does not mind if Ukraine reverts to full presidential rule. “It does not matter to me what the head of the executive power is called: a prime minister, a chancellor, a president or a *hetman*.”

A bigger question is what kind of Ukraine will emerge from the crisis. And that will be determined not by elections, but by the willingness of political leaders to push through structural reforms.

Poland's economy

Not like the neighbours

Apr 23rd 2009 | WARSAW
From The Economist print edition

Most east European economies look sickly, but not Poland—so far

A LOT like South Korea, a bit like Mexico and not at all like its neighbours. That is how Poland wants to be seen after it set up a $20.5 billion credit line from the IMF. This was not a bail-out like those for Ukraine, Hungary and Latvia. It was a precautionary and unconditional overdraft offered only to top-quality borrowers, say officials. The only other country to get similar treatment is Mexico.

A more flattering comparator is South Korea which, like Poland, has let its currency slide, while shunning the deficit-swelling policies of Britain and America. The zloty has fallen by 30% from its peak. The central bank has cut interest rates from 6% in October to 3.75%. Poland faces the crisis in a stronger position than many. Krzysztof Rybinski, a partner at Ernst & Young in Warsaw, points to consumption of 61% of GDP in 2008, close to Western levels. Rapid wage growth and low debt make consumers more robust.

This is partly luck. An overly tight monetary squeeze early in this decade headed off an asset-price bubble. Bureaucratic government checked the property boom; so did tough bank regulation that restrained the borrowing, chiefly in foreign currency, that plagues Hungary. “The things that you criticised Poland for in the past are now proving a blessing,” says a senior official.

The government’s gloomiest forecast is of a rise in GDP this year of 1.7%. Neil Shearing of Capital Economics thinks GDP is more likely to fall by 3%. Unemployment, swollen by returning migrants from western Europe, is already 11.2%. Exports have stalled. Industrial production in the first quarter was down by a tenth on a year ago. Ill-considered currency hedges have hit some firms. Tax revenues are sagging. The government’s efforts to prepare for euro entry by 2012 look “fairly futile”, says Mr Shearing. He thinks 2015 is more realistic.

Yet firms that survived the bureaucratic and other problems of the past 20 years are a resilient lot. Krzysztof Sklorz, whose Katowice-based company exports bricks and tiles, says zloty instability is a problem. But, he adds, “I took out a loan in euros and that’s what my clients pay me in as well, so that’s all right.” Unconsciously echoing Schumpeterian notions of creative destruction, Jozef Przyblya, a hotelier in another Silesian town, Pszczyna, says the crisis has weeded out the “weak and reckless”. The strong euro brings new guests from Germany and even Slovakia (now in the euro). One survey found that over 60% of big firms plan new investment this year. German subsidies to car buyers have stoked demand at Polish factories.

Unlike others in eastern Europe, Poland’s government is strong and stable. But its main contribution, says Marcin Piatkowski, a former IMF economist now at Warsaw’s Kozminski Academy, has been “brilliant PR”. Downplaying the crisis has been good for confidence, but doesn’t help promote much-needed reforms, he notes. One such is of bureaucracy: Poland comes 76th in the World Bank’s ranking for ease of doing business, below Kazakhstan. Mr Rybinski calls this “shameful”.

At least limited reforms to health care, pensions and the labour market are under way. One excuse is that President Lech Kaczynski vetoes laws put forward by a government he detests. Yet by the standards of the region, both Poland’s politics and its economy look pretty good.

Germany's Social Democrats

The underdogs bark

Apr 23rd 2009 | BERLIN
From The Economist print edition

The Social Democrats set out their electoral stall

THEY are the underdogs. With five months to go before the federal election on September 27th, the Social Democratic Party (SPD) is lagging ten points behind its partner in the grand coalition, the Christian Democratic Union (CDU). Frank-Walter Steinmeier, the foreign minister and the SPD's candidate to unseat Angela Merkel as chancellor, is half as popular as she is. The SPD cannot afford to wait to make its move until the campaign's "hot phase" a month or so before the poll. So it launched its offensive on April 19th by presenting its programme and candidate to 3,000 supporters in a stuffy concert hall in Berlin.

The strategy is two-pronged. Mr Steinmeier, chief of staff to the previous SPD chancellor, Gerhard Schröder, must convince voters he would handle the slump at least as well as Ms Merkel. But he will also argue that the economic crisis raises questions about fairness and the role of the state that only the SPD can answer. "When a bank manager earns as much as 500 nurses, something is wrong," thundered the bureaucrat-turned-politician.

The crisis has raised the spirits of a party that has long been in the dumps. Mr Schröder's Agenda 2010 reforms, which tried to push the unemployed into work by curtailing benefits, split the SPD and soured relations with trade unions. The Left Party has poached disgruntled SPD supporters but is not yet deemed fit to be a potential partner in government. Last year the SPD's membership fell below that of the CDU for the first time. It leads the government in just five of the 16 states.

The SPD started pulling itself together in September by replacing its accident-prone chairman, Kurt Beck, with a canny veteran, Franz Müntefering, and picking Mr Steinmeier as chancellor-candidate. Arguments between reformers like Mr Steinmeier and the party's left wing have been calmed. Even as the CDU squabbles over tax cuts and curbs on bosses' pay, the SPD is more united, insists Andrea Nahles, a leading left-winger. "Nobody talks any more about further deregulation," she says. "The debate is about strengthening society and democratising the economy."

But while the SPD hints at radicalism, its plans are modest. It wants to soak the rich (a bit) and cut taxes for low earners. It would tax stockmarket trades and raise the top income-tax rate from 45% to 47% on incomes over €125,000 ($162,000) for single people. Inspired by the government's cash-for-clunkers scheme, which pays drivers to scrap old cars to buy new ones, the party proposes a "bonus" of €300 (€600 for couples) to taxpayers who earn too little to file tax returns. Mr Steinmeier promised an active industrial policy but said little about what that might mean. To induce women to vote against Germany's first female chancellor, the SPD suggests that women should hold at least 40% of the places on companies' supervisory boards.

Its rivals denounce this as left-wingery. "We really couldn't work with this SPD any longer," said Ronald Pofalla, the CDU's secretary-general. Yet the SPD's left wing failed to win support for a wealth tax. The spending proposals are "almost fully financed", says Karl Lauterbach, an SPD Bundestag member. The idea of the tax cuts is to reward workers, not recipients of government transfers—which makes them sound like an extension of Agenda 2010.

The SPD hopes that, as unemployment climbs, it can chip away at the CDU's lead. Yet its main aim, says Frank Decker of the University of Bonn, is to block a coalition between the CDU and its preferred partner, the liberal Free Democrats. If it succeeds, there may be another grand coalition with Ms Merkel as chancellor. Mr Steinmeier might not object strenuously. Even as a junior partner, the SPD has nudged the government in its direction.

ETA and the Basques

Once bombed, twice shy

Apr 23rd 2009 | MADRID
From The Economist print edition

A weakened ETA may not find a Spanish government willing to talk to it

EPA

Another chief arrested

THE Basque separatists of ETA used to grab headlines with their terrorist attacks. Now they win them when yet another leader is nabbed. On April 18th it was the turn of Jurdan Martitegi, who police believe had been ETA's military chief for four months, to be arrested in France. At least he outlasted his predecessor, who held the job for just three weeks. The previous military head had the post for a full six months before being caught.

This churn at the top is good news. Each arrest forces ETA to reorganise, leaving it less time to plan and to plant bombs. Mr Martitegi and seven others arrested with him seem to have been planning a car-bomb attack in early May. That would have given a bloody welcome to Patxi López, a Socialist poised to take over as the Basque region's first non-nationalist premier since 1980.

The serial arrests of ETA's military chiefs may be even better news in the long term. The four captured over the past year apparently belonged to a hardline faction that pushed for an end to ETA's ceasefire two years ago. Now there are signs that the peaceniks have regained control. Josu Urrutikoetxea, a veteran who took part in talks during the ceasefire, is said to be back near the top. Arnaldo Otegi, who has served time in jail for terrorist offences, has reappeared as a spokesman for ETA's political arm. He is said to want a negotiated end to four decades of violence.

Yet the Madrid government of José Luis Rodríguez Zapatero may not be in a mood to negotiate. ETA made a fool of Mr Zaptero in late 2006, when it exploded a car bomb at Madrid's Barajas airport, killing two people, during its most recent ceasefire. The interior minister, Alfredo Pérez Rubalcaba, noted that this was the third time that a Spanish government had been burnt after talking to ETA. There will not be a fourth, he declared after the latest arrests.

Divided Cyprus

A hawkish problem

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From The Economist print edition

A nationalist election win in northern Cyprus dims reunification hopes

THE prospects of a united Cyprus receded when a nationalist party won the parliamentary election in the north on April 19th. The National Unity Party, led by the hawkish Dervish Eroglu, took 44% of the vote, giving it 26 of the 50 seats. The vote for the ruling Republican Turkish Party, which backs reunification, fell to 29%. This reflects voters' disillusion over the UN-sponsored peace talks that have dragged on since Turkish troops seized the northern third of the island in 1974 after a failed attempt by ultra-nationalist Greek-Cypriots to unite with Greece.

The result will also damage Turkey's faltering membership talks with the European Union. Turkey faces a December deadline to open air- and seaports to Greek-Cypriots. It refuses to do so until the EU eases trade restrictions on northern Cyprus. Sweden, which takes on the EU's presidency in July, is looking for a way to avert yet another train-wreck between Turkey and the EU. One idea is for Turkey to open a symbolic port or two only (though this was also tried two years ago by the Finnish EU presidency).

Hopes of a breakthrough now hinge on talks between the Greek-Cypriot president, Demetris Christofias, and his Turkish-Cypriot counterpart, Mehmet Ali Talat. Mr Talat led the campaign to persuade Turkish-Cypriots to vote in favour of the UN's Annan plan to reunite the island in 2004. But the Greek-Cypriots overwhelmingly rejected the plan in a separate vote, so Cyprus joined the EU as a divided island. The Greek-Cypriots have been subverting Turkey's EU membership talks ever since.

The mood improved markedly when Mr Christofias, who like his fellow left-winger, Mr Talat, favours a settlement, was elected president in February 2008. Substantive peace talks began last year with the backing of Turkey's government, still keen on a settlement similar to that proposed in the Annan plan. This calls for the establishment of a bi-zonal, bi-communal federation between Greeks and Turks.

Mr Eroglu publicly espouses the idea of reunification, saying that talks between Mr Talat and Mr Christofias must continue. Yet many suspect he prefers the status quo, which means continued dependence on Turkey and keeping 30,000 Turkish troops. Mr Eroglu talks of sending "a representative" to the peace talks. If he sticks to his campaign pledge to scrap a commission set up under Mr Talat to return occupied properties to Greek-Cypriots, the talks may collapse altogether.

Despite all this, Mr Talat met Mr Christofias again on April 21st. In a show of support, Turkey's prime minister, Recep Tayyip Erdogan, made clear that he would not tolerate mischief-making by Mr Eroglu. "We will not be supporting any steps that will weaken the hand of the president," Mr Erdogan insisted. Some fret that Mr Erdogan may yet yield to hawks in his own party. Another worry is whether Turkey's generals really want a deal.

What is clear is that the EU complicated matters hugely by letting a divided Cyprus join. "Had [the EU] been less rigid and cleverer, it would have lifted the sanctions long ago and thereby minimised the dependency of northern Cyprus on Ankara," argues Yavuz Baydar, a commentator. It would also have eased Turkey's accession to the EU. But that is just what Turkey's detractors inside the EU do not want.

Universities in Europe

Bolognese sauce

Apr 23rd 2009 | PRAGUE
From The Economist print edition

A birthplace of higher education tries to become its future too

WHEN European education ministers met in Bologna in 1999 and promised within a decade to forge a common market for universities, it seemed mere Euro-rhetoric. Big obstacles stopped students nipping abroad for a term, or getting degrees recognised. Many countries offered no degree below Masters level. Some examined course modules separately, others all in one go. Under the Erasmus programme many students travelled to other European countries for between a term and a year—but they often found their universities reluctant to give them credit for it.

Yet on April 28th no fewer than 46 European education ministers—from the European Union and 19 other countries, including Russia and Turkey—will gather in another ancient university city, Leuven, to declare the "Bologna process" a triumph. A "European credit-transfer system" is on its way; next year will bring a "European higher education area". There will be a standardised "diploma supplement" giving details of what students have learnt. And three-year Bachelors degrees followed by two-year Masters are now the general rule, with few exceptions.

"The big surprise was that the Bologna process worked at all," says Jean-Marc Rapp, president of the European University Association. Bologna is neither an inter-governmental treaty nor an EU law. He credits the eastern European countries that joined Bologna in 1999 for some of the success. Their governments were itching to reform communist-era universities and delighted to have a template for it—and their students were wild to travel.

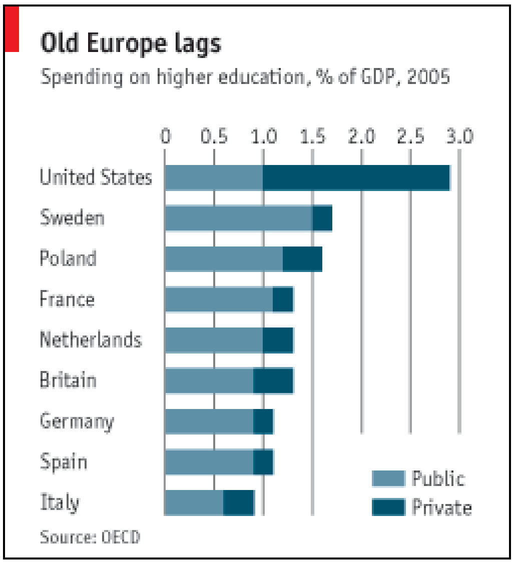
Another reason why some governments embraced Bologna was to give cover for reforms they wanted anyway. Shorter, more work-related degrees appealed to the Germans, keen to stop students hanging on for years at taxpayers' expense. In France, changes to university financing have been called "Bologna". In Spain "Bologna" is the excuse for introducing fees for Masters degrees.

Many students now anathematise "Bologna" as a capitalist plot. They plan protests in Leuven; already, students have taken to the streets in France, Italy, Spain and Greece. The resemblance to the Anglo-American system, plus Bologna's emphasis on graduate employability, are big grievances. Some academics fret that the secret aim is to privatise universities. Bologna's endorsement of more autonomy could lead (horrors!) to more freedom for universities in hiring, promotion and pay.

Europe is littered with historic universities (Bologna is the oldest, founded in 1088). But the paucity of European institutions and the ubiquity of American ones at the top of international league tables are a constant reminder of the gap between glorious past and mediocre present. For believers, Bologna shows the way to a future that will be glorious once more.

Yet this vision of self-governing universities, footloose students and job-ready graduates omits one big reason for European universities' decline: money. In America, the gap between what governments pay and what universities need is made up privately, mainly by tuition fees. In most of Europe students pay nothing. Even in England, tuition fees are capped by the government at low levels.

Europe's universities have seen funding per student fall behind wage inflation by 1-2% a year over three decades. America devotes far more of its GDP to higher education (see chart). Bruegel, a Brussels-based think-tank, finds that universities carrying out top-class research and leading league tables have both more autonomy and more money. If Europe delivers only one of these, it may not be enough.



Old Europe lags
Spending on higher education, % of GDP, 2005
0
0.5
1.0
1.5
2.0
2.5
3.0
United States
Sweden
Poland
France
Netherlands
Britain
Germany
Spain
Italy
Public
Private
Source: OECD

Charlemagne

Fishy tales

Apr 23rd 2009
From The Economist print edition

Only radical actions can save Europe's fish—and its fishermen

Illustration by Peter Schrank

ASK insiders to describe the European Union's fisheries policy, and you get a string of colourful metaphors. When fishermen want to catch more than scientists recommend, they are seeking "the right to cut their fingers off, one by one", says one official. The December meetings at which ministers set catch limits are a "Barnum's circus guided by short-termism", says another. It is hard to disagree. Each December, supposedly rational politicians haggle for two days and nights to reach an irrational result. Quotas are often as much as 50% above those urged by scientists. National controls on fleets and harbours are so patchy that the EU's Court of Auditors said in 2007 that real catch levels were "unknown". Fishermen then exceed quotas with impunity.

On April 22nd the European Commission published a consultative green paper on the common fisheries policy (CFP), suggesting some radical changes. It is a remarkably honest, even angry document. Fully 88% of the EU's stocks are overfished, it says. In the North Sea, 93% of cod are caught before they can breed. Most EU fishing fleets lose money or are barely profitable, despite direct aid and huge hidden subsidies such as tax-free fuel. In several countries the cost to public budgets of subsidising fishermen "exceeds the total value of the catches". That means a taxpayer eating local fish has, in effect, paid for it twice.

Several big ideas lurk in the green paper, even if not all are fully spelt out. The first is that the root problem is overcapacity. Many fishing fleets are 60-80% too large, says Joe Borg, the fisheries commissioner. Second, the EU should learn from countries like New Zealand and Iceland, where fishermen hold individual fishing rights that can be sold or leased to others. The trading of rights has led to the creation of smaller, more efficient fleets. Giving fishermen an asset with long-term value has also created peer pressure to fish sustainably.

Many EU countries, including Britain, Denmark, the Netherlands and Spain, already have some form of trade in fishing rights. The radical proposal buried in the green paper is that such rights should be tradable between national fleets, creating an EU-wide market. That challenges the principle of "relative stability" that governs the CFP, under which the share of fish stocks doled out to each country is meant to remain stable in relative terms. This fiddly principle is a fish-killer. Imagine two countries that both fish cod. One exhausts its quota every year, the other does not. But their quotas cannot be rebalanced, because of relative stability. Instead, the overfishing country must seek an increase in catches for the whole EU, endangering fish stocks. Alternatively, it must resign itself to dead cod being discarded by its national fleet

because they cannot legally be landed.

Eurosceptics say the answer is to scrap the CFP and have national fisheries. But this is illusory. In Europe's crowded waters fish stocks and historic fishing rights straddle national boundaries. A policy based on national fleets would make the tragedy of the commons worse. Yet will EU governments agree to market-based reforms? The Danes, Dutch and Spanish are in favour. But France and Ireland oppose them—and they have allies.

French fishermen who recently blockaded the Channel ports of Boulogne, Calais and Dunkirk provide a case study in both why changes are needed and why they will prove hard. For anyone scanning the headlines, the protests looked simple. The trawlermen said they were disgusted at having to throw dead fish overboard because EU quotas were set stupidly low. France was being betrayed, they roared patriotically: look at big cod quotas given to Norway. Predictably, the French government bought the fishermen off, offering them some €4m ($5m) to stay in port until a new quota period starts. Politicians hate confrontations with fishermen: they do a romantic, dangerous job in picturesque places, earning them much public sympathy. Yet the simple headlines obscure a much more complex story.

Channel fishermen near Calais or Boulogne usually catch sole and langoustines. In a biological accident, lots of cod were born in 2005 in a small area near their home ports. For the past couple of years, whenever they have fished they have caught cod. Because theirs is not normally a cod area, they have low cod quotas: indeed the local cod bonanza will be over in a year or so. Shouting about Norway is beside the point. Norwegian cod are a wholly separate fish stock. When fishermen express horror at discards, be equally sceptical. Trawlermen all over Europe chuck dead fish away to free up holds for more profitable specimens.

A time to trade

Other French regions such as Brittany have spare cod quotas. But France does not allow trading of fishing rights between regions, fearing that market forces would lead to fleets being concentrated in the hands of a few firms and large ports. For the Calais cod, it wants a top-down solution involving help from other governments. If instead EU-wide trading were allowed, Channel ports could cash in the valuable cod in their waters by leasing fish quotas from fishermen in next-door Belgium. But France is sworn to oppose cross-border trading. Some French skippers might not thrive in a free market. The Channel ports' fleet is notoriously badly managed and politically militant. In a single market, its rights might soon be snapped up by more efficient Dutch or Spanish firms. Spanish firms frighten Scottish politicians too.

The politicians should be braver. Some Scottish fleets, and some from French regions like Brittany, are efficient and well run. Their skippers should be winners from a single market in fishing rights. Small boats could be exempted, to protect pretty little harbours. Above all, only rational, efficient fleets can save Europe's fish. Politicians who resist radical changes to the CFP will go down in history not just as cowards, but also as despoilers.

Economist.com/blogs/charlemagne

Education reforms

Out the window

Apr 23rd 2009
From The Economist print edition

Never properly implemented and too timid in the first place: Labour's policies for improving schools have failed

Illustration by S. Kambayashi

NO ONE knows children better, or has their interests more at heart. So education reforms that put power in the hands of parents have an obvious appeal. Arm them with hard facts about how schools are doing; allow schools to diversify and compete to attract parents; allow parents to choose the ones they like best—and watch the power of competition drive up standards for all. This, in a nutshell, has been Labour's prescription for education since it came to power in 1997, and, with minor variations, that of the Conservative government before them.

That it hasn't worked is now clear. Literacy and numeracy standards in primary schools, which improved during Labour's first term, are flattening out—and independent observers agree that much of the initial rise was illusory, a consequence of teaching to the test. The results of the GCSEs and A-levels taken by 16- and 18-year-olds are still rising. Grade inflation and savvy schools pushing children towards easier subjects is the consensus, again denied by the government. The gap between the exam results of rich and poor children shows no sign of narrowing. And now all three tactics—information, diversity and choice—are looking shaky.

Most of the information for parents on schools' performance comes from the standard-assessment tests (SATs) in English, maths and science that children used to take at seven, 11 and 14. These are imperfect: raw results reflect a school's social mix, adjusted versions are hard to understand, and the tests' troubled recent history means they may not be long for this world.

Last summer the company hired to mark the SATs made a mess of the job and was sacked. The government dropped the tests for 14-year-olds and found someone else to mark the others. Seizing its moment, the National Union of Teachers, the most militant of the teaching unions and one that had been against the tests from the start, decided at its annual conference in March to ballot its members on boycotting those that remain. The head-teachers' union will decide whether to follow suit at its own conference next month.

Both unions will be emboldened by a growing political row. On April 22nd the head of the exams regulator, who had resigned after the fiasco, told MPs that ministers had made him the fall guy. They had made statements, he said, that were “flawed”, “sexed-up”, “fiction” and “totally false”. (He declined, when asked directly, to say they lied.)

As for the diversity of Britain’s state schools, parents have long known it to be largely illusory. Most secondaries are labelled “specialist” in one of a dozen fields, from mathematics to music to media studies, but this is mere flim-flam. Parents hardly care; schools can “specialise” in whatever they like, as long as they teach the standard subjects well and crack down on misbehaviour and bullying.

But the fact that choice is turning out not to mean much bothers parents a lot. As teachers—never keen on parental choice—and Labour’s old guard like to point out, parents do not have the right to choose a school, but merely to “express a preference”. If too many express the same preference, some will be disappointed—and each year, around a fifth of parents are. All that changes is the number who go on to appeal (up each year), and the number of appeals that succeed (down).

Parent power

Real choice for parents would mean real consequences for schools, of the sort that businesses experience in a marketplace. Good ones would grow. Bad ones would close. But the government has refused to take its reforms to their logical conclusion. Instead, it has tried to use the tools supposedly intended for parents to mimic the effects of the market, compiling hit lists of schools with poor exam results. Some of these are to be given school-improvement partners to chivvy them into raising their game, some taken over by better-performing neighbours, and some closed forthwith and replaced by “academies”—state-funded independent schools that are overseen directly from Whitehall.

But these half-measures do not seem to have done even half the job. Research by the Institute of Education published on April 21st looks at those corners of the state-education system where some parental choice does exist. Even there, it turns out to be neither unleashing competition nor raising standards.

Unlike most other state-funded schools, religious ones select pupils according to their parents’ devoutness, rather than their proximity to the school. This means that religious families have a wider choice of school than most: they are given preference by distant religious schools and can still apply to secular ones nearby.

The study looked at GCSE results in both sorts of schools. “We could have found that faith schools benefited all parents, including those who didn’t, or couldn’t, choose them, if other schools improved in an attempt to hang on to pupils,” says Anna Vignoles, one of the researchers. But they came across no such benign competitive effects—indeed, they found no effects at all. Children at religious schools made no more progress than those at secular ones, and areas where there were many religious schools did no better than those where there were few. “What is described as a quasi-market clearly is not working,” concludes Ms Vignoles.

That might be because religious schools in fact pose little threat to secular ones. The latter may know that a limited supply of faith-school places means many parents will have to settle for a secular alternative whether they want to or not.

Or it could be that, by giving religious people more choice than other parents, the government has weakened competitive pressures in another way. The researchers checked which schools had the most students with the best prospects for academic success in their neighbourhoods. Most religious schools turned out to have more than their fair share of bright, well-off kids, and correspondingly fewer stragglers and poor ones. If secular schools with religious neighbours know that whatever they do they will get lumbered with the hardest pupils to teach, they may resign themselves to being at the bottom of discerning parents’ wish lists and give up trying.

Choice, then, is unlikely to have any impact on standards unless it affects the supply of places. Both of the main opposition parties recognise that. The Tories would allow charities, churches and groups of parents to open schools, even where existing ones have plenty of capacity. They cite free-market reforms in Sweden, where new schools have, in a little over a decade, captured a tenth of the market. The Liberal Democrats, Britain’s third party, have similar plans, with the addition of a “pupil premium”—extra cash for each poor child a school admits. Either scheme would give more power to parents than the government

has managed to do in 12 years.

Economist.com

WORLD
BRITAIN

Deflation and student loans

Payback time?

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From The Economist print edition

Students hope for a bonus as Britain pitches into deflation

IN 1960, when Britain last experienced deflation, university students would have been puzzled by the idea of borrowing from the government to pay for their studies. These days, as inflation sinks below zero once more—prices fell by 0.4% in the year to March, according to the retail-prices index (RPI), an official measure of broad inflation published on April 21st—graduating with hefty debts is the norm. Debtors might normally dread deflation, which increases the real value of their loans. But students now hope that falling prices will provide them with a windfall.

Interest on student loans is pegged to inflation, as measured by the RPI, in order to maintain the real value of the debt over its term. The rate is set each year in March, which means that the interest rate prevailing in the academic year beginning in September will, in theory, be -0.4%—a transfer from state to student. Debtors are giddy at the prospect that taxpayers will be forced to pay off part of their loans for them. The government, which never foresaw such an eventuality, seems unsure. Last month it said a decision would be made if and when inflation went negative; it now says it need not decide until September.

Student loans are an unusual case. Dozens of state benefits are pegged to the RPI, but officials have promised that handouts such as jobseeker's allowance and housing benefit will at worst be frozen. The state pension, also linked to the RPI, must go up by at least 2.5%, following a promise made by ministers a few years ago when inflation fell and pensioners got shirty.

The National Union of Students is adamant that loans taken out before 1998, at least, are eligible for negative interest payments. On more recent loans, it concedes that the government has more room for manoeuvre, thanks to a change to the law which says that interest rates must simply be "no higher than those which the secretary of state is satisfied are required to maintain the value in real terms of the outstanding amounts".

In fact, even the pre-1998 borrowers may face an uphill struggle to get any money back. Unless a "right of set-off" is explicitly included in the contract, interest payment is a one-way street from the borrower to the government, according to Lucy Newcomb, a partner at Addleshaw Goddard, a law firm. "For the government, the worst-case scenario is that no interest is payable," she reckons.

In the long run, it may be no bad thing for students if they miss out on this particular fillip. The loans are already extremely soft: Nick Barr at the London School of Economics points out that almost a third of the government's costs are never recovered, because the interest it charges students is less than what it has to pay to borrow the money itself. Many beneficiaries are well-off students who borrow the maximum and pop it in a savings account to earn interest. If they were actually to receive rather than pay interest on their debt, calls to toughen up the system in general would probably get a more receptive hearing.

McLaren racing cars

Speed merchants

Apr 23rd 2009 | WOKING
From The Economist print edition

A Formula 1 team spreads its wings

A SLIPPERY rain-soaked circuit in Shanghai did Lewis Hamilton no favours in the third Formula 1 (F1) race this season. The young British world champion, who came sixth in the Chinese Grand Prix on April 19th, nonetheless praised the efforts of his McLaren team to boost the performance of his car back at their base in Woking. Workshops elsewhere in Britain were busy too: first and second places in Shanghai went to Sebastian Vettel and Mark Webber of Red Bull Racing, headquartered in Milton Keynes. Jenson Button, of Brackley-based Brawn, came third. Six of the ten leading F1 teams are based in Britain.

Motor racing is a big British success story. From a motley collection of enthusiastic racers and specialist designers, a cottage industry has arisen that is unrivalled around the globe. Some 4,500 firms are now involved in racing, sports-car engineering and related functions such as event management. Their annual turnover is reckoned to be in the region of £6 billion.

The McLaren headquarters, designed by Lord (Norman) Foster to swoop elegantly around one side of a large artificial lake, leaves visitors in no doubt as to which firm considers itself the leader of the pack. But a bit like Mr Hamilton's racing car, not all is running sweetly at McLaren.

Just before the Shanghai race Ron Dennis, who signed up Mr Hamilton when the future champion was just 13, suddenly stepped down as boss of the F1 team after 43 years in the sport. Mr Dennis, who remains group chairman, is by his own admission "not always easy to get on with". His resignation was the result, some concluded, of strained relations with the Hamilton family after the opening Australian Grand Prix. Mr Hamilton, who was eventually disqualified, was allegedly ordered to lie to race officials about an overtaking manoeuvre by another driver. Mr Hamilton has since apologised and a McLaren official has been sacked. But the team could still face sanctions when the sport's governing body, the Fédération Internationale de l'Automobile (FIA), holds a hearing into the incident on April 29th.

Mr Dennis decided it was time to go. Even before the brouhaha he had started to step back from running the team. He will soon be fully occupied with a project that has been bubbling away for two years: putting the McLaren badge on a new sports car to be made in a purpose-built factory employing up to 800 workers.

With Britain's carmakers in deep trouble, it might seem a curious time to start a new car firm. But Mr Dennis is betting that by the time the new McLaren sports cars go on sale in 2011, economies will be recovering. He is seeking investors prepared to put up £250m for a half-share in what will be a separately run McLaren Automotive. Mr Dennis now owns 15% of the McLaren group. The other shareholders are a Bahraini investment company (with 30%), TAG Group, a watchmaker, with 15%, and the McLaren racing team's engineering partner, Germany's Daimler group, the owner of Mercedes-Benz, with 40%.

McLaren already builds a small number of exotic cars for road use. Production of a special version of the Mercedes-Benz SLR sports car will soon come to an end with 75 limited-edition 200mph roadsters called the SLR Stirling Moss, after the legendary racing driver. They will cost £700,000 each, and look like 1950s racing cars, with two tiny windscreens.

The pretty new sports car envisaged now, codenamed P11, will be virtually a mass-market offering, in supercar terms. Costing about £100,000, it will compete with the likes of a Ferrari F430 or a Lamborghini Gallardo. Production could reach 4,000 a year, a big leap in volume for a racing-car manufacturer. And therein may lie the rub: British engineers have historically been better at designing cars than manufacturing them in any quantity.

Whereas F1 racing will provide all the marketing McLaren needs (provided the team can get back onto a winning streak), the new sports cars will still need to be ground-breaking to succeed. "Forget what you know, we will be different and do things differently," promises Mr Dennis. Competing through innovation

is, they say, what drives the F1 racing spirit.

Whistleblowing

Conscience be your guide

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Inside informants are better protected in theory than in practice

CITIZEN journalism is supposedly having a heyday, thanks to the arrival of the internet. But members of the public, nursing moral outrage or less noble grievances, have been exposing dodgy goings-on in business and government for years. Their revelations can bring down the rich and powerful: Sir James Crosby, an ex-boss of Halifax Bank of Scotland, resigned from the Financial Services Authority (FSA) in February after Paul Moore, a former HBOS employee sacked in 2005, accused him of mismanaging the bank. Often, though, it is the whistleblower's own career that suffers most.

A rash of insider revelations has raised questions about how protected whistleblowers are from the consequences of their public-spiritedness. On April 16th Margaret Hayward, a nurse, was struck off the register of recognised nurses by the Nursing and Midwifery Council (NMC) after she smuggled a camera into a Brighton hospital to expose on television the appalling standard of patient care on one of the wards. She joins Alex Dolan, a teacher suspended by the General Teaching Council for secretly filming unruly behaviour in schools in London and Leeds. A former employee of the FSA who wrote to Vince Cable, a Liberal Democrat MP, alleging that regulators had been deaf to warnings about the imprudence of building societies, so far remains anonymous.

In theory, the law shelters whistleblowers. In a flush of youthful idealism, the new Labour government passed the Public Interest Disclosure Act (PIDA) in 1998. Anyone reporting acts of official or corporate malfeasance (from risking workers' health to damaging the environment) is protected from retribution—provided he acts in good faith and goes through the right channels. That usually means taking his worries to his boss or to a regulator, at first, but in exceptional circumstances—if he believes his boss will simply cover up the allegations, for instance—he can go straight to the press. The protection is not absolute: whistleblowers lose their rights if they break the law (which can cause problems for officials subject to Britain's stringent official secrecy laws, for example). Soldiers, spies, volunteers and the self-employed are not covered. Nevertheless, Britain's law is seen as cutting-edge by other countries, says Francesca West, chief policy officer at Public Concern at Work, a charity that campaigns for whistleblowers' rights.

But that does not mean it is working perfectly. Ms Hayward's case illustrates a big loophole: although employers, such as hospitals or schools, cannot directly sack a whistleblowing employee, professional bodies, such as the NMC, are not covered by the law and can withdraw accreditation. The NMC argues that the nursing code guarantees patients' right to privacy, and that Ms Hayward violated it. And once nurses or doctors (or accountants or teachers) have been struck off a professional register, their careers are effectively over.

Simon Fenton, an employment lawyer at Thomas Eggar, a law firm, points out another unintended consequence of the rules. Unlike damages for unfair dismissal, which are capped at £66,200, the payout if a worker is fired for whistleblowing is unlimited, just as it is in sexual- or racial-discrimination cases. Many fired employees now throw in dubious whistleblowing claims, he says, in an attempt to persuade firms to settle out of court.

Official enthusiasm for PIDA seems to have cooled, too, perhaps because so many high-profile whistleblowers are to be found in the public sector these days. In 2004 ministers decided to make data on whistleblowing claims secret, so it is hard to tell how well the act is working. The torch has now been picked up by the Tories: they want explicit protection for whistleblowers to be written into NHS employment contracts, as well as an anonymous hotline set up for worried staff.

Ms West, however, is sceptical: "Ideally, you want a culture in which people aren't scared to point out problems." And she cautions against encouraging anonymity: a manager who discovers an anonymous whistleblower's identity may try to fire him on trumped-up charges.

MPs' expenses

Rush job

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From The Economist print edition

The prime minister's oddly hasty overhaul of MPs' expenses

Illustration by Claudio Munoz

GORDON BROWN had seemed content to await the verdict of an independent committee. Even after it emerged, last month, that the home secretary had charged the taxpayer for her husband's pay-per-view pornographic films, Mr Brown merely asked the Committee on Standards in Public Life to accelerate its review of MPs' allowances. Then, on April 21st, he suddenly announced measures of his own, which he wants Parliament to ratify almost immediately.

In a statement made via the internet rather than in the House of Commons (and throughout which he intermittently flashed an eerily inappropriate smile), Mr Brown said he wanted to scrap the controversial "second-home allowance"; under it, MPs can claim up to £24,000 a year for properties that supposedly let them conduct their duties in both Westminster and their constituencies. Under the new plan, MPs with constituencies outside London would be able to claim a flat-rate daily allowance for their political work. Receipts will have to be submitted for all travel and other remaining expenses. Parliamentary staff would in future be employed directly by the House of Commons, rather than by the politicians themselves (who are often the aides' spouses or parents).

Mr Brown doubtless hoped to close down an issue that has caused serial humiliation for the government (though other parties have been implicated too): the employment minister claimed expenses on a residence lived in by his parents; members of the cabinet have made second-home claims while living in grace-and-favour government properties and renting out their "first" homes. That last dodge would no longer be possible under Mr Brown's proposals. Such is the level of media furore and political sensitivity that Labour MPs may obediently vote Mr Brown's scheme through next week. The independent committee's review, still ongoing, may thus be rendered pointless.

Mr Brown's intervention raises a new slew of questions. The most obvious one is how much the new allowance will be. Some MPs may find themselves better off under the new arrangements (though the 54 MPs who represent outer London, and would not be eligible for Mr Brown's per diem, will not be).

Perhaps more important, is this really the most transparent option that Parliament can devise? A similar system at the European Parliament has been abused—by politicians who "clock on" at the beginning of a day and then disappear, for instance. Nick Clegg, the leader of the Liberal Democrats, worries that Mr Brown's solution would "bring the Brussels gravy train to Westminster". It seems odd that the prime minister has leapt from the over-generosity of the current model to the blunt hand-outs of his preferred one. There ought to be a way for MPs to be more precisely reimbursed for legitimate expenses.

A further question is why Mr Brown performed this striking YouTube U-turn so hurriedly, and on the day before the budget. The part of his plan that would require full disclosure of MPs' incomes from second jobs—of the kind that several members of the shadow cabinet hold down—suggested a bid to use the ongoing controversy for partisan advantage. (Mr Brown consulted Mr Clegg and David Cameron, the Tory leader, only after his announcement. Both were unimpressed.) The imminent disclosure of several years' worth of parliamentary expenses, which will doubtless involve more embarrassments, may also be part of the story.

Bagehot

Who's nasty now?

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The Labour Party are the nice guys of politics or they are nothing

Illustration by Steve O'Brien

NEAR the end of "The Secret Diary of Adrian Mole", a fictional adolescent's view of Britain in the early 1980s, a photograph of the prime minister is desecrated: someone breaks into the headmaster's office and scrawls "Three million unemployed" on Mrs Thatcher's cleavage. Sensitive Adrian writes a poem to protest her economic depredations: "Do you weep, Mrs Thatcher, do you weep?...Do you wake with 'three million' on your brain?"

The recession of the 1980s, and the Conservative government's alleged callousness towards its victims, engendered a reputation that eventually caught up with and nobbled the Tories. Reinforced in the 1990s by their phobic positions on homosexuality and immigration, it was summarised by Theresa May, now the shadow welfare secretary, at the party conference of 2002: the Tories, she acknowledged, were perceived as "the nasty party". That was then. After this week's budget, who's nasty now?

Even with Alistair Darling's risibly optimistic assumptions, this budget was the most depressing in a generation. The days when the headlines on budget day concerned the price of a bottle of Scotch now seem blissfully prelapsarian. Borrowing is stratospheric, the deficit vast—and, though the chancellor avoided this particular projection, unemployment is heading for the iconic 3m mark. Like the abolition of "boom and bust", Labour's once-vaunted pursuit of full employment now looks woefully hubristic. Mr Darling pledged to save the unemployed from the "scrapheap" of 1980s legend; but his main remedy—menial jobs for young people out of work for more than a year—was austere.

Another aspect of the Tories' mythical nastiness involved public spending. "Tory cuts" was a slogan that helped win Labour three elections. But cuts can cut both ways. The modest "efficiencies" adumbrated in the budget—the growth in public spending is to be reduced to 0.7% from 2011, meaning reductions for some departments—may not be sufficient to balance the books; but they are enough to change the politics of public expenditure. Labour's incipient bid to distinguish between their own nice cuts and the nasty ones the Tories might inflict is hopelessly sophistical. As David Cameron, the Tory leader, put it, Mr Brown now finds himself "on the wrong side of his own dividing line".

Much the same is true of the politics of poverty. The financial crisis was supposed to be Labour's progressive moment: the market was discredited, the benevolent state resurgent. Yet Mr Darling was unable to make more than a meagre, token tribute to Labour's anti-poverty goals. Twelve years of Labour

have called into question whether the state is equipped to cure entrenched social ills. It is now too broke seriously to try.

That leaves the purported niceness of Mr Darling's tightened squeeze on the rich, via the upwardly revised new rate of income tax on earnings above £150,000 ($218,000) and other pinches. Perhaps the government's political bet—that the time and mood are right for rich-bashing—will pay off. Or perhaps the measures will be seen for what they are: calculated, unproductive spite masquerading as justice. And the Tories' main tax accusation still stands: that Labour has nastily burdened future generations of taxpayers with the cost of its own fiscal imprudence.

Nasty guys finish last

There are two ways to think about political nastiness and niceness. The first is in the budgetary lexicon of impersonal millions and gazillions. The second is in terms of everyday behaviour. This sort of nastiness is more easily intelligible than the aggregate kind and is at least as important—because many voters form their judgments on character first and policy only secondarily. This was Mr Cameron's original intuition: he realised that as long as they seemed nasty, the Tories would never get a fair hearing.

That is why the recent scandal over vicious slurs concocted by Mr Brown's ex-henchman matters. And it isn't only the smears: a general miasma of personal nastiness hangs over the government. Mr Brown is now pushing a reform of the parliamentary allowance system—but only after assorted colleagues were caught in creative accounting. An opposition spokesman was arrested at the unjustified urging of the Home Office. Ministers intermittently manoeuvre to inherit their party's leadership. Other penumbral events contribute to the image: barbarous policing; the alleged complicity of the government in torture.

This is a caricature, of course. There are honourable people in the government and principled advisers working in Number 10, even if their unheralded service is obscured by the crass antics of spin doctors and the demagoguery of some ministers. Mr Brown himself has unquestionably done much to galvanise global action against third-world poverty and disease. But his brief, benighted premiership, like this week's budget, has been crowded with low politics and bereft of high ideas. In short, it has often seemed nasty: not a useful, stringent, purgatorial nastiness of the kind Mrs Thatcher administered. Just plain nasty.

Labour desperately wants to revive the sobriquet that Mr Cameron spent the early years of his leadership escaping; thus the constant refrain about how he would "do nothing" to ease the pain of the recession. There is indeed some residual nastiness among the Tories, and not only in the rank and file: Mr Cameron's notion of the "broken society" is gloomily reactionary. But the impression of Labour nastiness is stronger, and may matter more. Governments of the left sell themselves principally on their motives—on their avowed compassion, vision of the New Jerusalem, etc. This is especially true of Mr Brown's: after the economic debacle and lesser administrative calamities, Labour cannot build their case for re-election on the basis of competence. Labour are the nice guys of British politics or they are nothing. At the moment, they look like the new nasty party.

Economist.com / blogs / bagehot

Correction: G20 protests and the Mental Health Foundation

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In last week's issue we said that a female protester had been hit by a policeman in the same demonstration in which Ian Tomlinson was shoved to the ground and later died. In fact, it was the next day. We also called the Mental Health Foundation's chairman Celia Johnson. She is Celia Richardson. Apologies for both errors, which have been corrected online.

UN conference on racism

Avoiding the worst

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From The Economist print edition

Despite the indignation caused by an Iranian tirade, some gallant souls were accentuating the positive after a UN deliberation on race

AP

IN ONE of the more dramatic scenes in modern diplomacy, a resolution describing Zionism as a form of racism, adopted by the UN General Assembly in 1975, was excoriated by Daniel Patrick Moynihan, America's UN ambassador, as an "infamous act" and a "terrible lie". Then in 1991, the resolution was reversed and (to quote another senior American diplomat) consigned "to the dustbin of history".

In both votes, the outcome matched the times: the first resolution was promoted by a Soviet-Muslim coalition in a spirit of cold-war antagonism; the second reflected expectations of a "new world order" with America at the helm. To judge by the disorderly scenes that unfolded in Geneva this week, at a UN conference on racism, today's international climate is far more rancorous than it was 18 years ago, and not too far from the poisonous mood that prevailed in 1975.

At this week's gathering, expectations were cautious, to put it mildly. A legion of critics (in governments and elsewhere) said the affair would just be a hatefest directed at Israel and the Jews: no better, they said, than the UN's anti-racism conference in 2001. Fear of a repetition had persuaded Australia, Canada, Israel and four European countries to stay away. So, at the last minute, did America, dashing hopes that a black president would warm to a discussion, however flawed, on racism.

The sceptics' case received a huge fillip from Iran's president, Mahmoud Ahmadinejad, who railed not only against Israel but the Western countries which helped found the Jewish state, and "under the pretext of protecting the Jews…made a nation homeless with military expeditions and invasion." Although in his public remarks he dropped an earlier formula which directly called in question the Holocaust, the speech led to a walkout by 23 European delegations. The governments that walked out (or stayed away) got notes of thanks from Binyamin Netanyahu, Israel's prime minister.

That scene is undoubtedly the thing that the world will remember most about the week's proceedings. Yet only a day later, supporters of the conference (including some sane-ish governments and NGOs) were speaking of success: the adoption of a resolution that might just be a landmark in the battle for tolerance and free speech.

Most of the European countries that walked out of Mr Ahmadinejad's speech made clear soon after that they were not quitting the whole conference. (Only the Czech Republic did; it now holds the European-

Union presidency, but on this matter it was not acting for the EU.)

For those who walked back in, another source of relief was the fact that few were inclined to follow the lead of Mr Ahmadinejad (the only head of government who was present) and focus mainly on Israel and the Middle East. This change of tone, plus the fact that a carefully drafted resolution was adopted by consensus, led some Western governments to claim that the sharp-tongued visitor had been neutralised. It all “showed just how out of step the Iranian government is,” said Peter Gooderham, Britain’s envoy to the UN in Geneva.

For diehard optimists in the human-rights world, Mr Ahmadinejad’s intervention was only a hiccup in the process of crafting a charter setting out principles that could guide national legislation and other efforts to combat racism.

It is true that some hard work went into making the final resolution easier for Western governments to sign. In early drafts, Islamic countries had sought to introduce a clause making defamation of religion a breach of human rights, with disturbing implications for freedom of expression. Iran, alone, had also sought to exclude any reference to the Holocaust.

AP

At war with infamy: Moynihan (right)

The document finally adopted makes no explicit reference to Israel and the Middle East. Its chief flaw, in the eyes of critics, is that it reaffirms the outcome of the 2001 conference, where the Jewish state had come in for much criticism. Despite that, Western human-rights groups hailed the new text’s exclusion of illiberal language deploring the “defamation” of faith; instead, it deplores the “derogatory stereotyping and stigmatisation of persons based on their religion or belief”. Thus “it recognises the primacy of individuals, not the primacy of religions or ideologies,” noted Agnes Callamard of the London-based free-speech group, Article 19.

For B’nai B’rith, one of a raft of Jewish groups which came to Geneva to voice alarm over the UN proceedings, the final text was still “fatally flawed” because of its allusion to the 2001 meeting in Durban. “The adoption of this document shows nothing has changed since 2001, no lessons have been learnt—and the hope for a unified approach to fighting racism and intolerance around the world will again go unfulfilled,” B’nai B’rith said.

But several human-rights groups concurred with Mr Gooderham’s view that the final statement “covers the ground pretty well”. It avoids some of the unwelcome language (from a Western standpoint) that was initially mooted.

“It’s a breakthrough because it overcomes the polarisation that existed between the Islamic countries and the Western world. It shows they can find common ground on issues that had caused this polarisation,” said Julie de Rivero, Geneva representative of Human Rights Watch (HRW), a global civil-liberties group.

For HRW, the outcome added weight to its contention that liberal-minded governments should stay in the room and argue rather than storming out and leaving the ground to noisy extremists. Perhaps so—but it might be a tad too optimistic to say that polarisation between the West, the Islamic world and other ideological and regional blocks has been overcome. In any case, some fresh evidence on that question will emerge next month—when the United States stands for election to the UN Human Rights Council in the hope of changing that body and making it less inclined to direct all its fire at Israel.

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Investment, arbitration and secrecy

Behind closed doors

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From The Economist print edition

A hard struggle to shed some light on a legal grey area

FOR those who know where to look, it is not difficult to establish that Ashok Sancheti, an Indian lawyer, is pursuing a claim under international arbitration against the British government. Many details of the case are to be found in the public domain, too. His complaint, the steps he has taken to resolve the matter, and even the make-up of the three-person tribunal considering the claim were all mentioned in a related judgment by Britain's Court of Appeal in November.

Yet last month, when asked to confirm the existence of the arbitration case, Britain's Foreign Office declined, citing "an implied general duty of confidentiality" over cross-border arbitration cases. The whole story highlights an anomaly that troubles some Western governments more than others. Commercial law operates in a climate of secrecy, especially when two or more private bodies are involved. International law (on human rights, say, or border disputes) tends to work more openly.

So what happens when the two worlds meet? In practice, privacy generally prevails, and things which may well be in the public interest to know are hidden from view. That happens ever more frequently because of a surge in the number of international investment treaties: from around 1,000 in 1990 to more than 5,700 now. Such treaties prescribe a bewildering array of methods for settling disputes, which typically pit a private claimant (whether individual or corporate) from one country against the government of another.

Canada, followed by the United States, has been the most vocal supporter of greater openness in arbitration cases. A sidebar to the North American Free Trade Agreement (grouping those two countries plus Mexico) calls for almost total transparency in the way rows are settled. But many countries are loth to follow suit.

Opponents of change have been reluctant to identify themselves, preferring to block the work of little-known committees. But one institution that is leery of changing the rules is the Milan Club of Arbitrators, an influential European body.

The sheer complexity of the field makes the reformers' work harder. Indeed, nobody is sure how many investment arbitration cases are being considered. UNCTAD, an agency dealing with trade and development, knew of 290 in 2007.

However, sticklers for secrecy may not be able to blind the public with legal science for much longer. Luke Eric Peterson, editor of the *Investment Arbitration Reporter*, a trade publication, expects a "pitched battle" to break out soon between backers and opponents of transparency. In part this will reflect pressure on governments from citizens and NGOs who want to know more. For example, some Germans, at least, want details of the €1 billion ($1.3 billion) arbitration claim that Vattenfall, a Swedish power firm, has brought against their government under the Energy Charter Treaty.

The bare facts of that case are public because it was filed at the International Centre for Settlement of Investment Disputes, which works with a modicum of transparency. But other dispute-settling bodies, even in countries known for open governance, are more guarded: for example, the Arbitration Institute of the Stockholm Chamber of Commerce, to which many energy disputes are referred.

Among the arguments for secrecy, one has obvious force. In cases involving defence contracts, national security could be at risk. Another concern is that if NGOs (green ones, say) become heavily involved in arbitration cases, the costs of securing a judgment, which are borne by the parties, will soar—and thus deter investors. At a minimum, this means that for change to work, all the main arbitration bodies will have to move in lockstep.

Supporters of secrecy are true to their own principles; they generally lay out their arguments in obscure places. One of their contentions is that disputes involving the state in its role as regulator should be dealt with on the narrow, technical facts, free from political pressure. But some question whether disputes of this kind can ever be purely technical; by their nature, arguments about important areas of public policy are bound to be political, says Marcos Orellana Cruz, an environmental lawyer and lobbyist in Washington, DC.

Also, in any argument where the stakes are high, journalists have usually covered the story before an arbitration claim has been filed, and they don’t stop doing so once proceedings start. Nor, says Loukas Mistelis, a University of London professor who sits on arbitration panels, is it possible to stop “formalised gossip” or leaks to newsletters and the media by the parties.

In theory, reform is in sight. A working group is now updating the 30-year-old rules of the UN Commission on International Trade Law, which are widely used in all types of arbitration. But it is scarcely hurrying; it has decided to complete a review of the rules for purely commercial cases before even considering the matter of greater transparency in cases involving states. And the parameters of that discussion, whose start has been deferred from this year to next, have yet to be set.

Economist.com BUSINESS

Computing

Mr Ellison helps himself

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From The Economist print edition

Oracle's takeover of Sun Microsystems is a surprise, but fits an industry trend

Illustration by David Simonds

"I AM very surprised. I have to think about it." That was the initial reaction of Steve Ballmer, the boss of Microsoft, the world's largest software firm. It was also the response of many in the computer industry to the news on April 20th that Oracle, another software giant, was paying $7.4 billion to buy Sun Microsystems, an embattled computer-maker and Oracle's neighbour in Silicon Valley.

It was no secret that Sun, which never really recovered from the dotcom crash, had been searching for a buyer. But most industry observers had expected it to restart talks with IBM, another industry heavyweight, which had offered to buy Sun in March. Others thought Cisco, the biggest maker of networking gear, would make a bid, since it has recently started to move into computing hardware, too. Some even predicted that Hewlett-Packard (HP), the number one computer-maker, would finally get involved, after rebuffing Sun.

Why would Oracle, which makes most of its money from databases and business software, buy a hardware firm? A big part of the reason is the outsized appetite of Larry Ellison, Oracle's flamboyant chief executive. His firm has spent around $30 billion buying 50 firms since 2005, among them software heavyweights such as PeopleSoft, Siebel and BEA. Buying Sun should help Mr Ellison achieve his goal of getting Oracle's revenues above $30 billion by the end of this year.

There is more to the deal than that, though. For although Sun makes most of its money selling server computers and storage devices, it is not just a hardware-maker. It has always been a "systems" company, meaning that it sells tightly integrated bundles of hardware and software. And in recent years it has been beefing up its software business as companies have increasingly eschewed its pricey proprietary servers and bought cheap standardised machines instead.

Mr Ellison is keen on two bits of Sun's software portfolio in particular. One is Java, a programming language that is the underlying technology both for many business applications and for software that runs on mobile phones. Sun never managed to make much money from it, in part because it wanted Java to be an open standard. But Mr Ellison may have different ideas. To him, it is "the single most important

software asset we have ever acquired." Sun's other crown jewel is Solaris, its highly reliable operating system, which is often used as the platform for Oracle's databases. More Oracle databases run on Solaris than on any other operating system, Mr Ellison notes. With control over both pieces of software, Oracle will be able to make them work together better.

This ability to integrate hitherto disparate pieces of technology, and thus make life easier for companies, provides further justification for the merger. For some time, Mr Ellison's vision for Oracle has been to become the Apple of the enterprise, hiding complexity from customers, just as Apple does with its powerful but easy-to-use consumer products. Taking over Sun, he said this week, provides Oracle with all the pieces to put together systems that reach from "application to disk". Oracle's engineers are already brainstorming about how to build "industries in a box"—complete computer systems that come fine-tuned for, say, banking or retailing.

Yet there are other aspects of the takeover which Mr Ellison prefers not to mention. Top of the list is open-source software. In recent years Sun has put together a sizeable portfolio of these free programs written by communities of developers, hoping that firms using this software would then buy its expensive hardware. By buying Sun, Oracle becomes the world's largest open-source company, prompting much debate among developers and users. There is particular concern about the fate of MySQL, a firm Sun bought for $1 billion in January 2008. It sells database software which is also available in a free, widely used, open-source version.

Next on the list is job losses. If Oracle's previous acquisitions are any guide, Sun's workforce, which has seen many waves of lay-offs in recent years, will be cut further, so that Oracle can meet its targets for the deal. Safra Catz, Oracle's president, expects Sun to contribute more than $1.5 billion to Oracle's bottom line in the first year and more than $2 billion in the second. Money, even more than the scope for tighter integration, also explains why Oracle is unlikely to ditch Sun's hardware business soon, if at all. It provides a healthy stream of maintenance fees, about 40% of Sun's sales.

Finally, the takeover is also a defensive move. Oracle did not want to let IBM get its hands on Java and Solaris, and felt it had to react to what looks more and more like a thorough restructuring of the computer industry. Since the early 1990s the industry has resembled a cake made of horizontal layers of technology, with each layer dominated by a few companies. Cisco, for instance, provided most of the networking gear. Sun and HP sold servers. Oracle was the leader in databases. IBM's mainstay was services. SAP, a German giant, ruled in business software.

This structure is now collapsing as the industry's heavyweights move into each other's layers. HP bulked up its services division by buying EDS, for example, and has also moved more into networking. Cisco will soon start selling servers, and has formed an alliance with several smaller hardware and software firms to build, in effect, a data centre in a box. The industry is, in other words, going back to its past, when it was dominated by a few integrated companies that tried to do it all.

This is, in part, a consequence of the industry's maturity: to keep growing, firms have to invade each other's markets. In addition, customers increasingly prefer to buy integrated systems from one vendor, rather than doing the plumbing themselves. New technologies such as virtualisation and "cloud computing" are also blurring the boundaries between the industry's layers. A server can now easily switch between being a computer, a storage device or a router (a box that directs network traffic). For computing to become a utility, which is the promise of the cloud, a data centre cannot be a hotch-potch of boxes cobbled together from different vendors, but must be tightly integrated.

Some analysts think the deal could accelerate this trend by triggering more acquisitions. IBM, for instance, may now be tempted to buy SAP, to pull even with Oracle and its big software portfolio. Cisco, which is sitting on $29.5 billion in cash, might take over some of its allies, such as EMC, a storage firm. Before Oracle's competitors do anything rash, however, they should wait to see how well Mr Ellison's firm can integrate Sun. So far Oracle has shown that it can make money by buying software firms, getting rid of overlapping products and unnecessary overheads, but otherwise leaving them much as they were. With the takeover of Sun, however, Oracle faces a more difficult integration. Will it enable Mr Ellison to help himself to a big slice of the industry's cake?

Power to the people (at a price)

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From The Economist print edition

Change is slowly coming to Germany's dysfunctional electricity market

Corbis

HEARTENING though it may have been to shareholders in RWE, the rosy earnings forecast released on April 22nd by Germany's second-largest electricity firm was unfortunately timed. RWE's prediction that profits would only go up over the next few years, recession be damned, comes just days after Germany's federal cartel office said it had started an investigation into electricity producers, including RWE, and the wholesale electricity market.

The competition regulator is trying to work out why energy prices in Europe's biggest economy are so stubbornly high, and in some cases still rising, even though oil and gas prices have fallen sharply. It suspects that generators may have been keeping prices artificially high by, for instance, shutting power stations in concert to limit supplies. Finding evidence of that sort of skulduggery may be difficult, and proving it even more so. But regulators need not look too hard to see that Germany's electricity market is broken and that a flawed liberalisation of the market over the past decade seems only to have entrenched many of its problems.

The first sign that the market is not working is in Germany's electricity prices, which are among the highest in Europe, even though it has access to abundant cheap coal. Moreover, Germany's electricity prices have remained persistently high even at times when they would have been expected to fall. Analysts at Credit Suisse, an investment bank, reckon the slowing economy will reduce electricity demand by about 5%. Coal prices have dropped by half from last year. Yet there is little sign that either falling demand or lower input costs are leading to cheaper electricity. Wulf Bernotat, the boss of E.ON, Germany's biggest electricity firm, said this month that he did not expect German consumer prices for electricity to fall this year.

The main reason Germany's electricity market is not working as it should is the lack of competition. The four biggest utilities in Germany generate more than 80% of its electricity; the top two, E.ON and RWE, more than 60%. Liberalisation has, if anything, exacerbated this. Germany had eight big electricity producers in 1997, before the government liberalised the market, but the number has since fallen by half because of mergers and takeovers, says Uwe Leprich of the Hochschule für Technik und Wirtschaft in Saarbrücken.

A second problem is that Germany's biggest electricity generators also own the networks that distribute electricity. Critics argue that this gives them a huge advantage over independent producers, which may struggle to gain access to the networks fairly or, if they do, gain as much information on supply and demand across the grid. The European Commission has long criticised this "vertical integration" but it has had little success in getting its members to agree to force firms to "unbundle" generation and transmission.

Change is, however, coming on two fronts. The first is that antitrust regulators in Germany seem to have woken up to the fact that the country’s electricity market is not competitive. And the European Commission is having some success in forcing firms to “unbundle” using antitrust powers. Late last year it closed an investigation into alleged price manipulation by E.ON after the utility agreed to sell its long-distance distribution network along with some of its generating stations.

And over the longer run, ambitious plans to increase the share of electricity from renewable sources may erode the dominance of the country’s four biggest electricity generators. Germany hopes to get as much as 30% of its electricity from renewable sources by 2020, and although few in the industry think the target will be met, there is nevertheless likely to be a huge investment in new generating capacity over the coming decades. Judicious action by antitrust authorities now could ensure that it adds to competition in the electricity market rather than simply entrenching the incumbents’ positions. But because of the high cost of renewable energy, even with more competition in the market, Germany’s power prices are likely to keep on rising.

EDF and Greenpeace

Nuclear conflict

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From The Economist print edition

Did EDF, France's nuclear-energy giant, spy on Greenpeace?

IN JUNE 2008 French members of Greenpeace, an environmental campaign group, blockaded three quarries supplying sand and gravel to the building site of a new nuclear-power plant at Flamanville in northern France. Greenpeace, a fierce opponent of nuclear power, boasted that it had delayed construction for EDF, which is the world's largest operator of nuclear reactors. EDF now stands accused of making an illegal intrusion of its own in its struggle to contain Greenpeace.

A French court is investigating whether EDF paid a private-investigations agency called Kargus Consultants to hack into the computer of Yannick Jadot, former campaign director for Greenpeace France, in order to predict the group's actions. On March 24th two senior executives in EDF's security division were charged in connection with an illegal intrusion into a computer system. The head of Kargus Consultants, Thierry Lorho, a former member of the French secret services, and a computer expert called Alain Quiros were also charged by the court. On April 10th EDF said it would temporarily suspend the two senior executives, Pierre François and his superior, Pascal Durieux, while the investigation went forward.

The affair is embarrassing for EDF, Europe's biggest energy company, which is 85% owned by the French government. The firm hopes to profit from a global revival of nuclear power. In December it bought half of the nuclear assets of Constellation, an American utility, and in January it completed a deal to buy British Energy, a nuclear utility. This week Jean-Marc Sabathé, director of security at EDF, told *Le Monde*, a French newspaper, that as a result of the affair "our industrial reputation is at stake at the moment when EDF is engaged in the renewal of civil nuclear power in France and internationally." Allegations of corporate espionage also reflect badly on the French nuclear-energy industry as a whole, which has been trying to improve its image and become more transparent.

EDF acknowledges that it had signed at least one contract with Kargus Consultants. According to confidential court testimony released by Mediapart, a French website, and seen by *The Economist*, EDF had organised surveillance of Greenpeace in France and more broadly across Europe since 2004. But Mr François and Mr Durieux deny that they asked Kargus to hack into Mr Jadot's computer or use other illegal methods. EDF has tried to portray itself as a victim of Kargus and has filed an action for damages, which the court has refused to accept. Kargus appears to dispute its former client's account; according to the court testimony, Mr Lorho said in response to questioning that EDF knew what method his firm would use to get into Greenpeace's computer systems.

EDF is also awaiting the outcome of another investigation. On March 10th the European Commission's antitrust authorities raided EDF's headquarters in Paris looking for evidence that it had abused its dominant market position to inflate electricity prices in France. It is so far unknown whether the competition body found any evidence. Even as it expands its reach internationally, France's nuclear champion is coming under increased scrutiny.

The PCCW case

Split decision

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A pivotal ruling strengthens the hand of Hong Kong's small shareholders

LI KA-SHING'S place in the stratosphere of Hong Kong's billionaires' club was enhanced not only by the vast amounts of money he made for himself, but also by the significant sums that, for many years, his operations made for his shareholders. How this worked was unclear: he has three primary companies and various other entities with overlapping interests including ports, property, energy, telecoms and retail. Opacity, and questions about whether shareholders received fair prices for assets shifted between various entities, resulted in low-level grumbling among local investors. But these were always drowned out by joy over the aggregate success.

In recent years tolerance for this casual approach to corporate governance has been wearing thin because of the extended slump in share prices, and because other tycoons who ran similarly convoluted empires did not generate such big returns. But the real blow, ironically, has been delivered by Mr Li's son, Richard (pictured). His machinations over Hong Kong's dominant telecoms operator, PCCW, have stoked widespread rage and done what many considered to be impossible: inspiring local regulators to take a critical look at the workings of Hong Kong's tycoon-friendly financial markets and intervene on behalf of small shareholders.

Reuters

The judges said what?

On April 22nd three appellate judges in Hong Kong overruled a lower court and declared that the territory's securities regulator had the right to block a clever deal structured by the younger Mr Li allowing himself and PCCW's second-largest shareholder, China Netcom, to take the company private. This meant the transaction had to be abandoned on April 23rd, when an agreement with HSBC to finance the buy-out expired. But the ruling's wider impact is likely to be much more profound.

The hearing itself was unprecedented. When it began, on April 16th, it was expected to be a formality, lasting just one day. Instead, Hong Kong was riveted by reports of small shareholders stepping up to complain of ill-treatment. Two of the appeals court's three judges weighed in, openly criticising the buy-out, with one calling Mr Li's offer "pathetic" and "outrageous".

Coverage of the trial in the local papers was out of all proportion to the deal's value of just $2.2 billion. Some of the interest can be explained by the recent history of PCCW. In mid-2000 Mr Li used a euphorically valued internet start-up to buy a big stake in Hong Kong's former telecoms monopoly. It was a lucrative deal for him, but a disaster for the many local punters who hung around, beguiled by his vision of building an Asian technology giant. Instead, PCCW's share price collapsed and Mr Li's attention shifted to varying ways to monetise his stake.

The buy-out proposal, made in 2008, called for Mr Li and China Netcom to acquire the 52.4% of PCCW they do not already own using borrowed money, and then pay it back by issuing a large dividend once the deal was complete. Many long-term shareholders were livid, believing that they should be entitled to any dividend without having to surrender their shares. Under Hong Kong law, a buy-out must be approved by a majority of the non-buying shareholders. Shortly before the critical vote in February in which the transaction was approved, a number of agents at an insurance broker previously controlled by Mr Li received gifts of 1,000-share lots with, it was alleged, the aim of getting them to endorse the deal.

Hong Kong's securities regulator immediately began an investigation into claims that the vote had been illegally rigged. But its efforts were dismissed on April 6th in court by a judge who ruled that splitting up large shareholdings for the purposes of pushing through a deal is legal under Hong Kong law. This decision had huge public-policy repercussions: in particular, it meant that family-controlled public companies, of

which there are many on the Hong Kong market, could always overrule smaller shareholders. In reversing the decision this week, the appeals court was responding directly to the many aggrieved shareholders in PCCW. Its ruling was a declaration that Hong Kong's markets are not run solely for the benefit of tycoons.

Intellectual property in China

Battle of ideas

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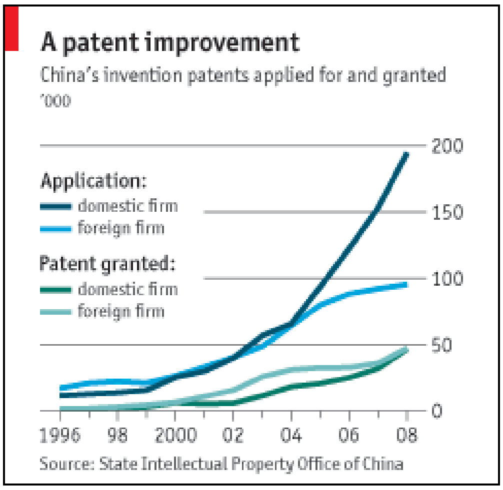
From The Economist print edition

Chinese companies are enforcing patents against foreign firms

FOR over a decade Schneider Electric of France has bombarded a Chinese firm, Chint Group, with lawsuits accusing it of copying its technology. But the tables turned on April 15th when the two companies settled an infringement case—with the French firm forking over $23m to Chint. The rich settlement against a foreign firm is a landmark. It serves as a reminder that Chinese companies are just as eager to defend patents as Western firms, and that China's intellectual-property regime has been tightened in recent years.

Long the workshop of the world, China wants to be the brains as well. The country's patent office leads the world in patent applications, more than 800,000 of which were filed in 2008. Most are for "petty" patents: middling technology that undergoes minimal review and receives only a 10-year term. Such patents are usually derided by research-intensive Western firms—but Schneider was stung by one that had been issued to Chint. And Chinese firms are increasingly filing "invention" patents that are rigorously scrutinised and receive 20 years of protection, as in the West (see chart). This year Chinese companies are poised to surpass foreign ones in receiving invention patents in China.



With the rush for patents has come an increase in disputes. Since 2006 more patent lawsuits have been filed in China than anywhere else, even litigious America. Most pit domestic firms against each other, but in recent years foreigners have found themselves on the receiving end too. In December Samsung, a South Korean conglomerate, was ordered to pay compensation to Holley, a Chinese telecoms firm. The recent victories and lucrative awards will open the floodgates to more suits, predicts Tony Chen of Jones Day, a law firm.

Intellectual property is relatively new to China. Patents date back to Venice in the 15th century, but Communist China did not allow them until 1985. Since 2006 it has pursued a deliberate policy of gathering as many patents as possible and developing home-grown technologies—not least because Chinese companies pay around $2 billion a year in licensing and royalties to American firms alone, according to America's Bureau of Economic Analysis.

Chinese firms are also increasingly seeking patents abroad, a sign that they plan to protect their technology when exporting it to rich countries. They won 90 patents in America in 1999 but last year they received 1,225. That is still relatively few—IBM, an American technology giant, receives around 3,000 a year—but it is increasing quickly. Because it takes three to five years to issue a patent, the number issued to Chinese firms is expected to soar soon. The quality of patents issued in China is also improving. Revisions to the patent law that take effect in October strengthen the requirement for a patent's novelty, bringing it up to global standards. Stronger patents are easier to enforce, opening the door to more lawsuits.

All these trends are important because countries that create intellectual property eventually enforce it as well, explains Dominique Guellec of the OECD. America, it is worth remembering, was the great copyright and patent infringer when it was a developing country in the 18th century.

Digital video recorders

The revolution that wasn't

Apr 23rd 2009 | LOS ANGELES
From The Economist print edition

DVRs were supposed to undermine television. They have done the opposite

TEN years ago this week a black box was demonstrated at a broadcasters' convention in Las Vegas. TiVo's digital video recorder (DVR) was expensive: the cheapest model cost $499. But it was hailed as revolutionary. It was much more flexible and easier to programme than a videocassette recorder. It allowed people to record and play back at the same time, so they could start watching a programme 20 minutes after it had started and fast-forward through all the advertisements. Experts forecast a severe, perhaps fatal, blow to advertising-supported television.

"For quite a few years people thought it was going to mean the demise of the television business," says Alan Wurtzel, president of research at NBC, an American broadcast network. Yet DVRs turn out to have done little damage. Indeed, DVRs (also known as personal video recorders, or PVRs) may even have protected television and made it more conservative.

On one point the Cassandras were correct. As prices fell and cable and satellite firms began to bundle DVRs with other services, their popularity soared. According to Nielsen, a media-research outfit, 29% of American homes now have one. The boxes are in a higher proportion of the households advertisers most care about. Jack Wakshlag of Turner Broadcasting, a cable company, calculates that DVR-owning households earn about $20,000 more than average. Yet those households do not use them nearly as much as one might expect. Families with DVRs seem to spend 15-20% of their viewing time watching pre-recorded shows, and skip only about half of all advertisements. This means only about 5% of television is time-shifted and less than 3% of all advertisements are skipped. Mitigating that loss, people with DVRs watch more television.

Just because technology enables people to do something does not mean they will, particularly when it comes to a medium as indolence-inducing as television. And people have become lazier. Early adopters of DVRs used them a lot—not surprisingly, since they paid so much for them. Later adopters use them much less (about two-thirds less, according to a recent study). David Poltrack, head of research and planning at CBS, another broadcast network, reckons the networks have already felt most of the DVR's effects.

Advertisers and television networks have pushed back even against this puny threat. They have developed relatively static advertisements that get a message across even at high speed. They put snippets of programming in the middle of ad breaks. One trick, described by Todd Juenger of TiVo as "closer to a silver bullet", is to run advertisements that resemble programmes—in some cases featuring stars from the show people are trying to watch.

Far from being revolutionary, in some ways DVR has made television more stable. With the exception of live events it is broadly true that the most popular programmes are recorded the most. Mr Wakshlag describes it as "a hit-saving machine". Broadcast television receives a bigger boost from DVR playback than cable television. The device has made it harder to introduce a new television programme, particularly at 10pm when people are likely to be playing back shows they recorded at 8pm or 9pm.

One reason television executives have calmed down about DVRs is that they have something else to worry about. Hulu and other video-streaming websites, which are becoming more popular, give a great deal of control to consumers and are thought to pose a threat to advertising-supported television. Does that sound familiar?

Economist.com BUSINESS

Trains in the Gulf

Making tracks

Apr 23rd 2009 | DUBAI
From The Economist print edition

European companies hope to prosper from railway mania in the Middle East

ArabianEye.com

Never mind skyscrapers, let's play trains

RAILWAYS have not made much news in the Middle East since Lawrence of Arabia blew up the Hijaz line in 1918. But bosses in the $165 billion global rail industry have been flocking to the Gulf lately, lured by the prospect of an investment boom. Every country in the region has drawn up plans for ambitious rail projects. Qatar and Kuwait are spending around $10 billion each, and the United Arab Emirates is shelling out twice that. On their shopping lists are monorails, bullet-trains and local metros, the first of which (pictured) will open in Dubai in September.

Not to be outdone, Saudi Arabia plans to spend $15 billion to increase the size of its rail network nearly five-fold. Pilgrims could be riding the rails to Mecca and Medina at 360kph (225mph) as early as next year, rather than plodding along the kingdom's notoriously crash-prone roads. And this is just the beginning. All these planned national lines will eventually be connected into a regional network, at a further cost of at least $14 billion. Leaders of the Gulf Co-operation Council agreed on plans for a great railway bazaar from Jordan to Oman earlier this month, though it may be two decades before their ambitious scheme is fully realised.

The main beneficiaries will be Europe's rail giants, many of which are keen to move beyond their mature home markets. American manufacturers have little experience with metros and high-speed trains, and most Asian rivals lack the necessary foreign-sales know-how. Europe is the industry's hub, accounting for 70% of sales and much of the innovation. Now the Gulf beckons as a lucrative export market.

Steaming ahead of the pack is France's Alstom, closely followed by Siemens of Germany and Bombardier of Canada. "The intake is phenomenal," says Michael Clausecker, director-general of Unife, Europe's railway-industry association, which predicts 25% growth between 2006 and 2016. Not all of the new demand is coming from the Middle East, however. In recent months countries including China, France and Britain have pledged stimulus money for trains, and on April 16th Barack Obama outlined plans for an extra $13 billion to fund rail infrastructure to unclog America's airports and highways.

But the richest pickings are undoubtedly to be found in the Gulf. Its cities are choking with traffic, as anyone who has driven to or from Dubai's airport will know. Even sheikhs get stuck in their limousines. "They have realised that public transport is not just for poor people," says Chris Antonopoulos, head of sales at Bombardier's rail division. But congestion is not the only motivation. Gulf states are preparing for a post-oil future, built around services, and that requires infrastructure. Giant train sets, like skyscrapers, also appeal as status symbols. "There is an element of showing off," says Philippe Mellier, president of Alstom Transport.

The Middle East is an almost ideal market for European manufacturers. It has no state-owned competitors to demand the transfer of expensively developed technology, as is often the case in Asia, where European trainmakers are reluctant to offer their best products for fear of breeding new rivals. The Middle East also has short replacement cycles, thanks to heat and sand, which means bigger follow-on contracts. And of course, there is plenty of money. Or is there?

When oil prices fell in 2008 and the Gulf's fortunes tumbled, the industry worried. Were the gleaming tracks in the Arab desert a mirage? On April 7th an industry-wide sigh of relief could be heard when Saudi

Arabia awarded the first contract for a line connecting the country from north to south. This is not the British "railway mania" of the 1840s, but the boom is on. "We've seen no evidence of projects being cancelled," says Chris Jackson, editor of *Railway Gazette International*. On the contrary: manufacturers are struggling to satisfy Gulf demand. The last thing a sheikh is willing to give up, it appears, is his 4,000-horsepower diesel-electric locomotive.

Face value

Pedal to the metal

Apr 23rd 2009
From The Economist print edition

What makes Fiat's Sergio Marchionne believe he can save Chrysler?

eyevine

IT IS just as well that high-stakes industrial poker is a game familiar to Sergio Marchionne, the chief executive of Fiat Group. In 2005 he laid the foundations for Fiat's spectacular recovery by extracting $2 billion from General Motors (GM) as the price for removing a put option that would have forced GM to buy the then-ailing Italian car firm. But even by his standards the next few days will be a daunting test of nerve and stamina from which only two outcomes are possible. Either Mr Marchionne will end up in control of Chrysler, the smallest of Detroit's Big Three—or he will have quit the table, consigning the sickly carmaker to almost certain bankruptcy. Everything hinges on the negotiations taking place between Mr Marchionne, America's Treasury, Chrysler's current management, the unions and secured debt-holders.

Mr Marchionne is confident that a deal can be done that keeps Chrysler out of the bankruptcy courts, but he recognises that a lot can still go wrong. There are signs that the unions, particularly in Canada, where much of Chrysler's manufacturing capacity is based, feel they have already conceded enough. The senior lenders, which include JPMorgan Chase and Citigroup, are going back and forth with the Treasury over how much of a "haircut" they will have to take on the $6.8 billion they are owed, and whether they will get a compensating equity stake. The Treasury itself will take some convincing to release the $6 billion it has promised in exchange for a credible recovery plan. Although Mr Marchionne has wowed the administration's auto task-force with his forceful personality and blunt style, officials still fear that even with Fiat's help, Chrysler may be too far gone to be turned around.

Why does Mr Marchionne believe he can salvage something from a firm that the rest of the industry sees as a basket-case—and which has defied the best efforts first of rich, successful Daimler and later of Cerberus Capital Partners, a sharp-elbowed private-equity group that acquired an 80% stake in Chrysler from the Germans two years ago? Quite simply, because he has done it before. When the Agnellis, Fiat's dominant shareholder, turned to Mr Marchionne, a corporate troubleshooter who was running another company in which they had an interest, they knew that Fiat's car business, representing half the group's turnover, was dying. Poorly led, bleeding cash, heavily indebted and saddled with ancient factories, stroppy unions and outdated products, Fiat had become synonymous with failure at every level.

Italian-born but raised in Canada, where he qualified as both a lawyer and an accountant, Mr Marchionne conforms to none of the caricatures of either country. Instead of sharp suits and elegant circumlocutions, he favours shapeless sweaters and brutal (expletive-laden) frankness; instead of patient consensus-building, he bulldozes his way through, burying corporate politics and flattening dysfunctional hierarchies

as he goes.

Mr Marchionne’s approach to Chrysler, if a deal can be done, is likely to be similar to what he did on arrival at Fiat in 2004. “The single most important thing was to dismantle the organisational structure of Fiat,” he recalls. “We tore it apart in 60 days, removing a large number of leaders who had been there a long time and who represented an operating style that lay outside any proper understanding of market dynamics.” In their place Mr Marchionne brought in a younger generation of executives who could respond to his demand for accountability, openness and rapid communication. Two key requirements that everyone had to understand were the need for speed and an end to the crippling political battles that resulted in scarce capital being wasted on little or no standardisation of parts and a ridiculous number of platforms (19 in 2006 will become six by 2012). The time taken to bring new cars from “design freeze” to production was reduced from 26 to 18 months, and a succession of handsome new models followed, capped by the launch in 2007 of the Fiat 500, the cool, retro-styled city car that embodied Fiat’s renaissance.

When a Fiat-Chrysler alliance was first mooted a few months ago, the idea was that in exchange for access to its small-car platforms and fuel-efficient powertrain technology, the Italians would receive a 35% stake in Chrysler. Now, although its initial stake will be scaled back to 20% and cannot reach more than 49% until Chrysler has repaid all the money lent to it by the taxpayer, Fiat will be much more firmly in the driving seat. If the deal is done next week, Mr Marchionne will be named chief executive and a new board of mainly independent directors will be recruited by Fiat and the Treasury.

The need for speed

The model chosen to run Chrysler will be like the one used by Carlos Ghosn when Renault formed its alliance with Nissan. Mr Marchionne will split his time between the two firms, while a hit squad of Fiat managers (some of whom are already crawling over Chrysler) will force through changes and develop synergies between the two organisations. The Italians have been shocked by how bloated Chrysler’s management still is—there are nearly ten times as many people in external communications as there are at Fiat—and the plodding, committee-bound decision-making process. “If this thing comes off”, says a Fiat senior executive, “they’re really in for a shock.”

Yet Mr Marchionne’s confidence that Chrysler can be saved using the same medicine that revived Fiat still does not fully explain why he is willing to risk trying to pull off an unlikely second miracle. Doesn’t he risk damaging his reputation and stretching Fiat’s thin management resources to breaking point? The answer is that he believes the car industry’s crisis will lead to consolidation and that Fiat, for all its recent success, is less than half the size it needs to be to survive in the future. And though he might not be ready to admit it, he has done pretty much all he can with Fiat in its present form—and there is a good deal more excitement and satisfaction in being the hunter rather than the hunted.

Awards: Business Journalist of the Year

Apr 23rd 2009
From The Economist print edition

Philip Coggan, our Buttonwood columnist, was the winner in the Best Communicator and Best Personal Finance Story categories at the Business Journalist of the Year Awards on April 22nd. Andreas Kluth, our staff correspondent in California, won in the Best Corporate Journalist category, and Fiammetta Rocco, our books and arts editor, won the award for the Best Profile.

Central banks

The monetary-policy maze

Apr 23rd 2009 | WASHINGTON, DC
From The Economist print edition

The simple rules by which central banks lived have crumbled. A messier, more political future awaits

Illustration by Derek Bacon

IN THE world that existed before the financial crisis, central bankers were triumphant. They had defeated inflation and tamed the business cycle. And they had developed a powerful intellectual consensus on how to do their job, summarised recently by David Blanchflower, a member of the Bank of England's monetary policy committee, as "one tool, one target". The tool was the short-term interest rate, the target was price stability.

This minimalist formula fitted the laissez-faire temper of the times. A growing array of financial markets could price risk and allocate credit efficiently. Central bankers had merely to calibrate their interest-rate tools and all other markets would automatically adjust. Central banks still cared about financial stability and full employment, but could argue these were best served by stabilising prices—without, if you please, interference from politicians.

The financial crisis has upended all that. The business cycle was supposedly subdued, yet the world is in the deepest recession since the 1930s. Deflation has become a more dangerous enemy than inflation; with interest rates in many countries at or close to zero, central banks have had to reach for other tools.

More fundamentally, the collapse of stable relationships in financial markets has forced central banks to make judgments they once left to the private sector. From lenders of last resort, they became lenders of first resort when banks stopped trusting each other. They are, increasingly, arbiters of which types of borrowers get credit. With the reputation of market discipline in tatters, central bankers will get vast new supervisory powers. All this is dragging central banks back towards political turf from which they had been distancing themselves for years.

Central bankers still believe that once the crisis has passed they will return to their pre-2007 roles as apolitical technocrats pulling a single lever and eyeing a single variable. It may be a vain hope. "When you question the basic premise which you have worked under for the last 15 to 20 years, which is that markets are rational and efficient, there is a case for a different approach to both monetary policy and regulation," says Thomas Mayer, chief European economist of Deutsche Bank.

Start with the most immediate question: what tools will central banks use to steer the economy in the

near future? Before the crisis almost all leading central banks operated through the short-term (usually overnight) money-market rate. By itself, that rate mattered much less to economic activity than, say, those on 12-month corporate loans or 30-year mortgages. But the links between these and official rates were stable enough to allow the central banks to influence overall financial conditions and hence the entire economy.

Those links came under strain before the crisis, as a global saving glut caused a decoupling of long- and short-term rates. During the crisis they disintegrated as lenders worried that loans could not be sold on or would not be repaid. Central banks responded by expanding their lending operations through a mixture of more types of credit and collateral, longer terms and more counterparties (see chart 1). The Federal Reserve began lending to investment banks. The European Central Bank (ECB) guaranteed unlimited funds for up to six months instead of one week. Some have gone much further. The Bank of Japan has bought equities and the Swiss National Bank has intervened in the currency markets.

Broader-minded banking 1

Changes in central-bank operations since 2007

	Lending operations				Outright purchases				Bail-outs, capital injections
	More counter-parties	More liberal collateral	Longer term	Foreign exchange swaps	Foreign exchange	Equities	Private debt	Gov't debt	
Australia		✔	✔	✔					
Britain		✔	✔	✔			✔	✔	✔
Canada	✔	✔	✔	✔			*possible*	*possible*	
Euro area		✔	✔	✔			*possible*	*possible*	
Japan			✔	✔		✔	✔	✔	*possible*
Sweden	✔	✔	✔	✔					
Switzerland			✔	✔	✔				✔
United States	✔	✔	✔	✔			✔	✔	✔

Source: Central banks

Even if the crisis is getting no worse, it is not over and most of the world is in recession. No central bank is about to withdraw any emergency measures. Some are contemplating new ones. Both the Bank of Canada and the ECB are considering outright purchases of government or corporate debt to boost the quantity of credit.

Central bankers assume they will wind down these measures when the crisis ends. The Fed, for example, is required by law to end some when the need is no longer urgent. It charges a penalty for some programmes so that borrowers will return to private markets once these have healed. An exit strategy is necessary to “end up with a market-based economy that is more balanced and more resilient,” Donald Kohn, the Fed’s vice-chairman, has said. Mervyn King, governor of the Bank of England, has said the exit strategy will be dictated by the outlook for inflation and that central banks should not support markets that cannot survive on their own.

In need of new targets

But withdrawal may be harder than it sounds. A study last year by IMF staff asked, “What will ‘normal’ look like?” It argued: “There is no expectation that markets will return to their pre-crisis mode of operation soon, if ever. Market spreads taking account of credit and liquidity risk had arguably become too compressed pre-August 2007, and are now wider than they should be long-term. But it is not clear what the appropriate level should be.”

After the Bank of Japan became the primary supplier of overnight funds to banks earlier this decade, the interbank market atrophied. It remains a fraction of its former size. European banks today are now heavily dependent on the Fed for dollars (supplied via swap lines with local central banks) and on the ECB for six-month euro funds.

A tepid recovery will make central banks reluctant to withdraw support from critical markets, especially if business or politicians protest. In 1942 the Fed agreed to hold down long-term interest rates to help the Treasury finance the war; it did not extract itself from the commitment until 1951. When the time comes

to sell its large holdings of mortgage debt, it may face resistance from America's housing lobby.

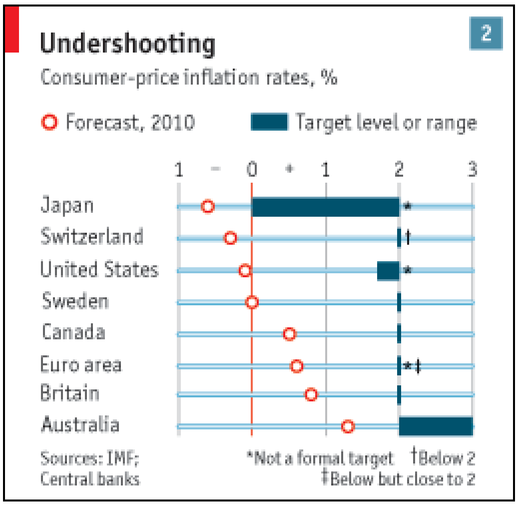
Central banks may not just have to rethink their tools. They may also have to rethink their goals. Governments and central banks had come to agree that they should focus only on achieving low and stable inflation. The Fed by law must emphasise employment and inflation equally, but in practice it, too, targets inflation. This consensus was forged in central banks' research departments and universities, and its adoption paralleled a rise by academics to the top ranks of central banks: among the leading lights are not only Ben Bernanke, chairman of the Fed, and Mr King but also Lucas Papademos, vice-president of the ECB, and Lars Svensson, a deputy governor of Sweden's Riksbank.

Macroeconomics in general has come under fire for depending too much on assumptions of efficient markets and its inability to incorporate the spasms of emotion that create economic manias and panics. "As a monetary policymaker I have found the 'cutting edge' of current macroeconomic research totally inadequate in helping to resolve the problems we currently face," said Mr Blanchflower, a labour economist, in a speech he gave on March 24th.

The exclusive focus on low and stable inflation is being questioned for the same reason. The recession began against a backdrop of price stability—as did America's Depression and Japan's lost decade. "Inflation targeting alone will not suffice," Mr Blanchflower said. "This approach failed to prevent the build-up of imbalances that presaged the crisis and was insufficient in dealing with failing banks and financial-market stress as the crisis developed. There is now a consensus that new tools are required to regulate the financial sector and prevent such crises in the future."

Mr Bernanke and his predecessor, Alan Greenspan, argued before the crisis that bubbles are hard to identify before they burst. Pricking them is even harder without wrecking the economy. Central banks should act only if bubbles threaten price stability; otherwise, they should wait and clean up after they burst. The shallow recession that followed the tech-stock boom of the late 1990s seemed to vindicate them.

Recent experience does not help their argument. William White, who retired last year as chief economist of the Bank for International Settlements, argues that because central banks were focused on price stability in the medium term, they allowed bubbles to form. The bursting of these raises the risk of deflation in the long run.

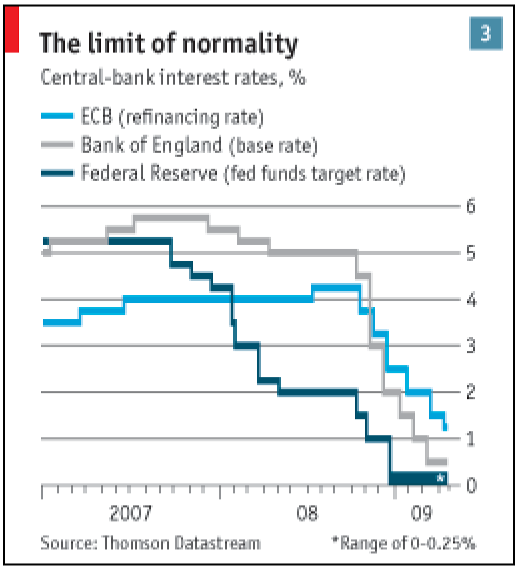


Inflation in many countries will be negative this year mainly because of cheaper fuel. But even in 2010, when that effect is fading, inflation will stay below the 2% most central banks define as price stability. In its latest forecast, published on April 22nd, the IMF says prices will fall in America, Japan and Switzerland (see chart 2).

To be sure, many central banks are more sanguine, noting that inflation expectations are, in the jargon, well-anchored. Many in the market fear that once the crisis passes central banks will be too slow to raise rates and wind down their credit programmes, unleashing inflation. But persistently falling prices would constrain central banks' ability to boost growth, because they would be unable to push interest rates below inflation—ie, make them negative in real terms. Using the Taylor rule, a popular rule of thumb, economists at Deutsche Bank suggest that given today's degree of economic slack and inflation rates, short-term rates should be negative in America, Britain and the euro area. Instead, they are at or near zero (see chart 3). Were deflation to deepen, real interest rates would rise, further hampering economic activity.

Eric Rosengren, president of the Federal Reserve Bank of Boston, noted recently that the Fed has hit, or all but hit, the zero limit twice this decade. That is more often than earlier simulations had indicated—and it suggests higher inflation targets should be considered. Another proposal is that central banks aim at a path for the price level rather than the inflation rate. Suppose that this path rose by 2% each year. Then after deflation of 1% in year one, the central bank would aim for inflation of more than 2% in later years (inflation of 5% in year two, say) to bring prices back

up to the target. Greg Mankiw, a Harvard University economist, goes further, suggesting that inflation simply be given lower priority. “There are worse things than inflation,” he says. “We have them today.”



Altering or abandoning inflation targets would make a big dent in the credibility that central banks took decades to establish and is therefore highly unlikely. And although benign neglect of bubbles no longer appears an option, central bankers are not ready to advocate pre-emptive popping, because the problem of identifying them early enough remains unsolved. Better, they argue, to use regulation to identify and defuse dangerous accumulations of risk in the financial system.

The term for this is “macroprudential” supervision. Last year Mr Bernanke laid out how this would differ from the normal supervision of individual banks. He said a single firm may have an acceptable exposure to a particular type of risk that would be unacceptable if replicated across many firms. Similarly, a supervisor might press a particular bank to lend less during a slump whereas a “macroprudential supervisor would recognise that, for the system as a whole,” that could make matters worse.

The embrace of macroprudential supervision represents a reversal of another pre-2007 trend—for central banks to shed supervisory duties and concentrate on monetary policy. Academics argued that supervision was a distraction from the pursuit of price stability and created potential conflicts: a central bank might run an inflationary policy to cushion a failing banking system, or prop up an insolvent bank to cushion the economy. Central banks in Australia and Britain gave up some or all of their supervisory roles. The ECB was created with none.

The run on Northern Rock, a British bank, and problems at state-owned German banks were blamed in part on inadequate involvement by the central bank in supervision. This year the Bank of England received a more formal role in overseeing banks. A commission headed by Jacques de Larosière, a former head of both the Bank of France and the IMF, has recommended that the ECB chair a new European Systemic Risk Council made up of its member central banks and supervisors, but that it remain out of firm-specific supervision. The Fed until recently was the leading candidate to fill the American Treasury’s proposed job of “systemic risk regulator”, empowered to examine any corner of the financial system and act against emerging risks.

Yet macroprudential supervision smacks of a fad that will not live up to its billing. It faces the same difficulty as conventional monetary policy does in spotting and popping bubbles. Moreover, there has been no correlation between a central bank’s supervisory responsibilities and its ability to prevent or deal with the crisis. The Fed is America’s most powerful and best informed financial regulator but the trouble began under its nose. Neither Australia’s central bank nor Canada’s has any supervisory duties, yet the financial systems of both countries have been virtually unscathed. This record has less to do with who supervises the financial system than with local laws and behaviour. Subprime mortgages peaked at about 1% of the total in Australia and 2.5% in Canada, compared with more than 14% in the United States.

Illustration by Derek Bacon

New combatants in the political arena

Rightly or wrongly, central banks will emerge from the crisis with a bigger role in the markets and in supervision. This will challenge another element of the pre-2007 consensus: that central banks be as far removed from politics as possible. Formal independence insulated the central bank from politicians’ desire to play fast and loose with inflation. And part of the appeal of “one tool, one target” was that it made monetary policy explicitly a technical rather than political affair.

The divide between central banking and politics looks much less clean today. Unconventional policies often require a central bank to make loans that may not be repaid in full. Because taxpayers will bear any losses, finance ministries need some say. Credit allocation

and tighter regulation make some firms winners and others losers, and so require more public accountability. With interest rates at zero, the Fed and the Bank of England are buying government debt to boost the quantity of credit and the money supply. But governments could come to rely on such purchases to finance budget deficits. The potential for political conflict extends abroad too. Having cut its rates to zero, the Swiss National Bank has bought foreign currency to drive down the Swiss franc. Some labelled this competitive devaluation.

Managing such conflicts is a delicate job. The Fed and the Treasury attempted to assuage concerns by releasing a joint statement affirming the Fed’s sole responsibility for price stability. Mr King broke a longstanding silence on fiscal policy to warn the British government against adding to a fast-growing national debt.

Such tensions are unlikely seriously to dent the institutional protections built around central banks in recent decades. Last year Japanese opposition parties blocked the appointments of two candidates to head the Bank of Japan on the ground they were insufficiently independent of the government. There are exceptions: Iceland’s government amended the law so that it could fire David Oddsson, the head of its central bank. But Mr Oddsson had presided, first as prime minister and then as central-bank governor, over the policies that led to the country’s crisis.

Central bankers’ jobs matter even more than they did before 2007. At the same time, they have been drawing more criticism and political scrutiny. Public disapproval ratings have risen notably for Mr Bernanke, the Bank of England and the ECB. They are having to defend their policies to the public as well as to the markets. Mr Bernanke agreed to a profile by “60 Minutes”, a news programme, in which he strolled down the streets of his hometown. Mr King sat for an interview with the BBC to explain quantitative easing. The six members of the ECB’s executive board gave 200 interviews last year.

After the Riksbank slashed its interest-rate target to 0.5% on April 21st, its governor, Stefan Ingves, took questions from the public in an online chat session. Asked what he liked most about his job, the former economics professor said that what he used to study in theory he now gets to put into practice. He added: “It’s fun to go to work every day.” You may wonder how many of his peers would agree with him.

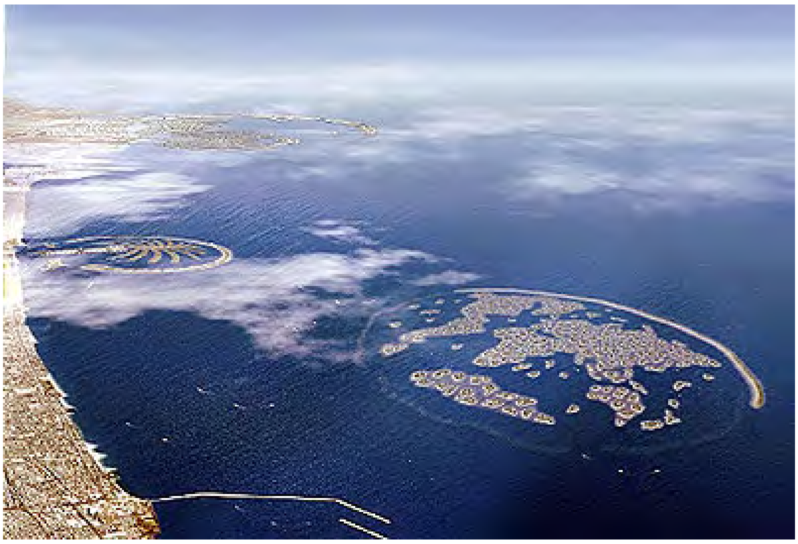
Dubai

A new world

Apr 23rd 2009 | DUBAI
From The Economist print edition

The crisis has hit the emirate hard, but it is wrong to write it off

AFP



THE first glamorous residents have already made a home for themselves at “The World”, an archipelago of 300 artificial islands (pictured above) created off the coast of Dubai by Nakheel, one of the emirate’s big three developers. Pilot fish and parrot fish have colonised the man-made reef surrounding the islands. The reef, built from 34m tonnes of rock, forms a protective ring around the islands—a breakwater that stops the Gulf’s currents from slowly washing The World away.

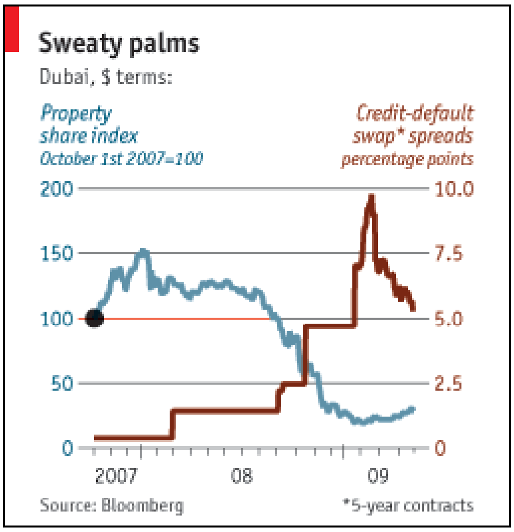
To its many critics, Dubai’s economy is as artificial as Nakheel’s islands. The emirate borrowed capital and labour to make speculative bets on real estate, of which The World is only one outlandish example. Now policymakers are scrambling to build an economic breakwater that might protect the emirate’s prosperity from adverse tides: plunging property prices, ebbing trade and tourism, and the unaccustomed difficulty of refinancing its ambitions.

The debt of Dubai’s government and government-controlled companies is about $80 billion. Almost $11 billion comes due this year (including interest) and $12.4 billion next. Nakheel alone must refinance a $3.52 billion bond in December and another worth 3.6 billion dirhams ($980m) five months later, according to EFG-Hermes, an Egyptian investment bank.

The rocks for Dubai’s breakwater have been provided by its neighbour Abu Dhabi. The wealthiest of the seven members of the United Arab Emirates (UAE), Abu Dhabi sits on 94% of the federation’s oil reserves. Through the central bank, it bought $10 billion of Dubai’s bonds, half of a proposed $20 billion issue. This bail-out, announced in February, has restored calm, as shown by the falling cost of insurance against default (see chart). The economy has shifted “from the crisis mood to the solution mood,” wrote Dubai’s ruler, Sheikh Muhammad bin Rashid al-Maktoum, in an online discussion with reporters on April 18th, his first in eight years.

The solution includes reshaping the archipelago of quasi-government companies known loosely as “Dubai Inc”. These enterprises mostly fall into one of three holding companies: Dubai

World, Investment Corporation of Dubai, and Dubai Holding, which belongs to Sheikh Muhammad himself. Each holding company boasts its own master-developer: Nakheel, Emaar and Dubai Properties.



The ruler was happy to devolve power to these companies, which were run like personal fiefs. The competition between them kept them on their toes, unlike sluggish ministries of urban development elsewhere. But the developers also fell prey to one-upmanship. Emaar is building the world's tallest building, so Nakheel announced a 1km tower that would surpass it. The government stood behind these companies, giving them the confidence to overreach. But the authorities did not stand over them, ensuring their plans cohered with each other and with reality.

During the boom, supply seemed to create its own demand. Developers sold properties before ground was even broken, asking for first instalments of 10% or even lower. This allowed speculators to buy ten apartments for the price of one, with the aim of selling them at a profit before the second instalment fell due.

The market peaked in September 2008, about 30 months after Dubai allowed foreigners from outside the Gulf to buy freehold properties in designated areas. Prices fell by about 25% in the last quarter of 2008, according to several of the private indices compiled in the absence of sound official data. They may have fallen by the same amount in the first quarter of 2009.

The market is sending a signal that even Dubai's bullish developers cannot mistake. In March, *Middle East Economic Digest* (MEED), a business journal, calculated that UAE developers had postponed $335 billion-worth of construction projects. One two-year project was proceeding so slowly that it would take 20 years to complete. Three months after announcing its 1km tower, Nakheel postponed it.

The restructuring of Dubai Inc has begun. Nakheel shed 15% of its staff in December and has continued to pare its numbers since. Sheikh Muhammad's own Dubai Holding has also cut staff. "Last year, people would talk about how many houses they owned," says one Dubai veteran. "Now, they talk about how many friends have lost their jobs." Other economies benefit from automatic fiscal stabilisers as the unemployed stop paying taxes and start spending welfare benefits. The UAE suffers from an automatic destabiliser: 30 days after a foreigner loses his job, he loses his right to stay. Once they leave, Dubai's ex-expats will spend nothing in the economy they leave behind.

Companies often keep people on their books (unpaid) while they look for alternative employment. But EFG-Hermes forecasts that Dubai's population will fall by 17% this year. Its workforce will shrink to fit a contracting economy, just as it grew to fit an expanding one. One architect in Dubai has proposed turning vacant labour camps, where migrant builders once lived eight to a room, into affordable housing for people who can no longer rent the apartments the labourers were hired to build.

Dubai lives in a good neighbourhood, however. Abu Dhabi, the next-door emirate, has 92 billion barrels of oil reserves and a sovereign-wealth fund with probably over $300 billion of assets. The consolidated balance-sheet of the UAE is not overly stretched. It is just that one emirate has most of the assets; its neighbour has most of the liabilities.

Good-neighbour policy

As Dubai's crisis deepened, everyone waited for its oil-rich neighbour to bail it out. The wait lasted an agonising few months, from the onset of the crisis in September until the central bank's decision to buy Dubai's bonds was revealed in February. What accounted for the delay? Many commentators argue that Dubai was reluctant to ask for help, and that Abu Dhabi asked for something more than 4% interest in return. Abu Dhabi was perhaps not unhappy to see Dubai's wings clipped and the federation tightened.

But Georges Makhoul of Morgan Stanley thinks it is wrong to describe the federation's deliberations as if they were a "family soap opera". He adds: "It's not as if people in Abu Dhabi are scheming about how to make Dubai suffer, and the people in Dubai are scheming about how to wring money out of Abu Dhabi." The offer of help was extended in November, he says.

In his online interview, Sheikh Muhammad denounced “vicious attempts” by the media to “fabricate differences between Abu Dhabi and Dubai.” He complained about a “media bombardment” of the UAE since the crisis broke. “I know that some people from outside the region have wished that [the] Dubai model will go down the river,” he says.

The critics of Dubai have indeed been as prone to overstatement as the Dubai developers they disdain. The Dubai model has deep roots. The emirate has, after all, been borrowing to invest in infrastructure since the 1950s, when it sold a bond to Kuwait to finance the dredging of its creek. The results of this investment are sometimes hubristic, but often impressive. The Jebel Ali Port, for example, is one of the biggest container docks in the world.

Dubai has also put similar efforts into its “soft infrastructure”. For example, the Dubai International Financial Centre has imported English law and international arbitration from London—even if it lacks the institutional history to back it up.

The skills Dubai needs to prosper are most abundant in the West. To attract these skills, it has turned itself into a country Westerners can enjoy, notes one Saudi onlooker. Saudi Arabia is a bigger economy offering more interesting work. But it struggles to attract the lawyers, financiers and other professionals it needs.

Not everyone is fresh off the plane, or booking their flights home. Dubai’s older family businesses, which trace their origins to Iran, India and Zanzibar, will not abandon the emirate during its downturn, any more than they were carried away by the boom. Dubai attracts people from 202 nationalities, according to the Ministry of Labour. Some of these people are footloose and flighty. But for others, the emirate is the only place in the region they would want to live. Dubai was a microcosm of the world even before Nakheel decided to build its island replica.

Property in America

Commercial break

Apr 23rd 2009
From The Economist print edition

Disaster looms in yet another asset class

GENERAL GROWTH PROPERTIES (GGP) and the Great Basin Bank do not have a lot in common. One is America's second-largest mall owner, the other a small bank in Elko, Nevada. But both shut their doors within a day of each other this month because of their exposure to commercial property, the most threatening in a line-up of suspect asset classes.

GGP filed for Chapter 11 bankruptcy protection on April 16th. Its assets, which include the Fashion Show Mall in Las Vegas (pictured) and South Street Seaport in New York, are high-quality and continue to generate decent income. Its financing structure is what got it into trouble. GGP found that it simply could not roll over its debts because of a lack of liquidity.

Alamy

Vegas fashion victim

GGP's difficulties were not unexpected. It was carrying lots of debt, principally because of a big acquisition in 2004, and much of it was short-term. But its failure still sends two shock waves. First, by including several properties that back commercial mortgage-backed securities (CMBS) in its Chapter 11 filing, GGP has unnerved investors who expect such assets to be ringfenced in a bankruptcy.

The second shock wave is that GGP's bankruptcy underlines a pervasive refinancing risk for the industry. Foresight Analytics, a research firm, reckons that $594 billion of commercial mortgages will mature in America alone between 2009 and 2011. Many of these borrowers will have a big problem when their loans mature. Just as in residential property, the financing terms that were available to property and construction firms got ever laxer as the bubble inflated. Loan-to-value ratios of 85-95% were common in 2006 and 2007. These have now tightened to 60-65% and below for new lending.

That would be bad enough if prices were static. They are not. Commercial-property prices have fallen by 35% or so in America. Richard Parkus, of Deutsche Bank, thinks that 70% of all CMBS issued recently in America will not be able to refinance without a big increase in the capital that borrowers stump up.

It is likely to be a similar story with bank lending. Many banks are extending loan terms, hoping that the problem will go away. It will not. A growing overhang of debt will only make it harder for the market to recover. And the full effects of the bust are only just beginning to be felt. Losses on commercial property tend to lag behind rises in the unemployment rate by a year or so, largely because lease terms protect landlords from immediate falls in rental income. (An exception is the hotel industry, where leases are, in effect, renewed daily). The pain is now arriving. Office vacancies in America's city centres increased to 12.5% in the first quarter, up from 9.9% a year earlier. Delinquencies are spiralling. Write-offs on bank-held commercial-property loans rose sevenfold in 2008.

The potential for further damage to the banks is especially worrying. Morgan Stanley's first-quarter results on April 22nd included a $1 billion loss on its real-estate investments. But the loan books are where the real concerns lie. Commercial-property loans, including construction and development, account for 22% of American bank loans, up from an average of 14% in the 1980s and 1990s.

Smaller banks are exposed. Matthew Anderson of Foresight Analytics says that banks with assets between $100m and $10 billion hold commercial-property loans worth more than three times their total risk-based capital. Great Basin Bank, the 25th American bank to fail this year, was undone by heavy losses on commercial property. It will not be the last.

Buttonwood

Down and out

Apr 23rd 2009
From The Economist print edition

It still looks too early for a housing rebound

Illustration by S. Kambayashi

THE housing market started this crisis so it is natural to think that house prices must recover before it ends. After all, most Americans and Britons seem to regard increasing home values as part of their birthright.

Any sign of an upturn has been seized upon by newspapers and estate agents. The latest data to excite the bulls have included a rise of 52% in house and condominium sales in southern California in the year to March and three successive monthly increases in the average asking price of British houses.

But the hallmark of the last boom was the excessive use of credit to buy assets. As the bubble has burst, the prices of other assets, such as corporate bonds and equities, have been driven down to below historic averages. Why should housing be any exception? After all, there was no shortage of speculators at the height of the boom and the current recession is expected to be the worst since the second world war.

Yet homes are still not cheap. Using the index of the government's Office of Federal Housing Enterprise Oversight, in 2008 American house prices were still around 25% more expensive, relative to earnings, than the long-run average. In Britain the Nationwide building society calculates a ratio between the house prices paid by first-time buyers and average incomes. This ratio peaked at 5.4 in 2007 and has since subsided to 4.1. But the low for the ratio (first calculated in 1983) was 2.1, recorded in the mid-1990s. If those lows are going to be revisited, either incomes will have to double (which will take a long time) or prices will have to fall by half.

The bulls will argue that affordability is more important than price-earnings ratios. In America 30-year mortgage rates have come down by a percentage point since this time last year, according to Freddie Mac, one of the twin government-backed housing-finance groups; the National Association of Realtors reckons that housing affordability is at an all-time high. But affordability is not just a question of low interest rates. Borrowers have to get access to credit and that means having the wherewithal to make the deposit.

That has got a lot more difficult, as figures from Britain show. According to the Council of Mortgage Lenders, the median advance (as a percentage of the purchase price) made to homebuyers fell to 75% in

February this year from 89% a year ago. In other words, the required deposit has more than doubled. In cash terms, this means British first time buyers are stumping up £32,000 ($44,000), more than the average wage, against £14,000 a year ago.

There are other ways of measuring housing valuation and these point to a transatlantic difference. Relative to GDP, British prices are around 20% more expensive than they were 40 years ago; American houses around 35% cheaper. American house prices have roughly kept pace with share prices over the last 40 years; British prices are not far from their relative peak.

It is a bit of a mystery why British house prices have outperformed those in America so strongly. The tax position is more favourable for American buyers (interest is no longer tax-deductible in Britain). The standard assumption is that the planning laws are more restrictive in Britain than in America and this pushes up prices; 3.4m homes were built in Britain between 1990 and 2007 compared with 27m in America. Of course, America is much larger. Census data suggest it added 23m households between 1990 and 2007 while Britain added around 3m. Supply and demand would seem to have been roughly in balance in both cases.

If there is no fundamental reason why British house prices have risen that much faster than America’s, the former may have further to fall. (Buttonwood should declare an interest: he sold his London house last year and is renting.) British unemployment is rising and wages are stagnant (up just 0.1%, year-on-year, according to the latest data). There are hopes that rich foreigners may take advantage of weak sterling at the top end of the market but that may be offset by the clampdown on bank bonuses.

A period of weak or falling house prices ought to be welcome. Young people will find it easier to afford their own place; those in their 30s and 40s may regard renting as a longer-term option (which makes for a more mobile workforce). British and American consumers have been obsessed with the idea of a house as their main store of wealth, regarding it as a combination of cash cow and pension plan. But the idea that we can all get rich by buying and selling each other’s houses was always an illusion. Maybe it will die out for a decade or two.

Economist.com FINANCE & ECONOMICS

Bank capital

Test of nerves

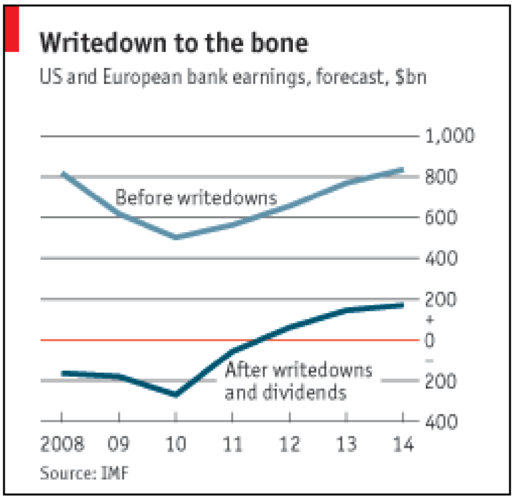
Apr 23rd 2009
From The Economist print edition

Americans fret about bank stress tests. Europeans keep their eyes wide shut

NERVES are fraying ahead of the Treasury's stress tests of American banks. On April 20th a leak of the results, claiming most banks were insolvent, terrified traders before being exposed as a hoax. Officials are Delphic. On April 21st Tim Geithner, the treasury secretary, told Congress that "the vast majority" of banks have enough capital. Then again, he said the results of the bail-outs were mixed.

How the tests will be unveiled is hardly any clearer. The Treasury says it will reveal some results on May 4th. A banal statement that all banks are fine would be met with derision. But if the gory details are disclosed and some banks fail the test, they will face a sell-off. Investors will probably bet that they will be unable to raise private capital within the six-month window permitted by the Treasury, and that the price of more government cash will be to wipe out existing shareholders and impose a "haircut" on junior bondholders. Ideally, the results and any capital-raising would be announced simultaneously for all banks. But for an industry barely capable of holding a keg party in a brewery, that may be an organisational feat too far.

America's banks may well need more help. Most lenders cannot borrow without state guarantees. Even JPMorgan Chase, seen as America's strongest bank, paid a big premium over government interest rates when it issued unguaranteed debt on April 16th. The IMF has just had a stab at estimating the size of the new equity that is needed. This is based on writedowns of $550 billion over the next two years (on top of the $510 billion already booked), and incorporates existing capital and underlying earnings (see chart). It concludes that American banks need $275 billion to keep their tangible common equity above a floor of 4% of assets.



The Treasury has only $110 billion left in its bail-out kitty. That suggests the heavy lifting will be done by hybrid instruments, such as preference shares, which are classified as tier-one capital but which act more like debt. America's ten biggest banks have $300-odd billion worth, about half of it from the state. Their capacity to absorb losses would rise if this was converted into common stock, which is the purest form of capital since it need not pay dividends. Citigroup has done this, and other banks' junior debt trades at distressed prices, reflecting the possibility they may follow suit.

This solution does have unpleasant side-effects. The government would end up with a 27% voting stake in the top-ten banks combined if all hybrid capital was converted at its book value. Although taxpayers are already propping up the system through debt guarantees, overt state ownership is taboo in many quarters—Mr Geithner says it "worries" him. Nor would it be fail-safe. Banks with high exposure to commercial property, for example, might still be overcome. Nevertheless, the government could impose a fairly stringent solvency test on the system without having to beg Congress for more cash.

Whether it has the will to do so remains to be seen. Yet when it comes to evading problems Europeans set the bar. American banks hold lots of securitised debt, which is usually marked to market. European lenders typically hold loans and impair them gradually. The result, says the IMF, is that $1.1 trillion of writedowns is expected over the next two years and only $334 billion has been booked already. Using the same method, it reckons European banks need $600 billion more equity. The possibility of converting hybrid capital would only go so far. Simon Samuels of Citigroup estimates that Europe's banks have only $325 billion of preference shares and tier-one debt. Little of this is government-owned, making its conversion trickier.

More government equity is needed. Britain and Ireland have done stress tests, although of debatable

severity. Spain and Germany are tackling their worst banks. But overall, Europe's strategy is to cross its fingers, bet that the Americans fudge their stress tests and hope for a rebound. If American policymakers are brave, and make their tests tough, Europeans may have to put aside their plans to unwind on the beach this summer.

Rating agencies

The wages of sin

Apr 23rd 2009 | NEW YORK
From The Economist print edition

The Fed is perpetuating a discredited oligopoly

BY MISREADING the risk in mortgage-backed securities and other “structured” products, the rating agencies Standard & Poor’s, Moody’s and Fitch played starring roles in the failure of finance. Their punishment? Oddly, the further entrenchment of their dominance, thanks to the Federal Reserve.

The Fed’s lending programmes, such as its commercial-paper facility and the Term Asset-Backed Securities Loan Facility (TALF), accept only collateral that has been appraised by a “major” rating agency, ie, one of the big three. This marks a setback for the seven rating firms that have been recognised by the Securities and Exchange Commission (SEC) more recently, including DBRS and Egan-Jones. It also sets the Fed in conflict with the SEC, which introduced reforms in 2006 to promote competition by speeding up the approval process for rating agencies.

The Fed has promised to consider expanding the list of eligible raters, but Ben Bernanke, its chairman, recently said he was “comfortable” with the big three’s revamped ratings models. Their rewards could be handsome: up to $400m in TALF-related fees alone, reckons Richard Blumenthal, Connecticut’s attorney-general. He has launched an antitrust probe and accuses the Fed of “rewarding the same companies that helped burn down the house”. Keen to restore securitisation’s credibility, Wall Street’s main trade groups, too, want the TALF opened up to smaller rating agencies.

Dan Curry, head of DBRS’s American business, notes that the Resolution Trust Corporation, which cleaned up the savings-and-loan mess in the 1990s, insisted on using firms of all sizes to rate the mortgage securities it issued. That gave a lift to upstarts, including Fitch. “Public agencies have tremendous power to influence the industry’s structure in times of crisis,” he argues.

The inspector-general for the government’s financial-rescue efforts this week urged the Treasury to scrap the use of credit ratings for TALF securities altogether and do the screening itself. That may seem far-fetched because investors still find comfort in ratings (a proposal to reduce money-market funds’ reliance on ratings was shelved last year after the largest funds voiced opposition). But better no ratings at all, perhaps, than those of a discredited oligopoly supported by a short-sighted central bank.

Economist.com FINANCE & ECONOMICS

World Bank

Forgotten sibling

Apr 23rd 2009
From The Economist print edition

As the IMF gets richer, will the poor get a raw deal yet again?

Reuters

AFTER the G20 met in London on April 2nd, Robert Zoellick, the World Bank's president, described the summit as "a promising beginning". He may have chosen his words carefully, however, because the feeling in Washington, DC, is that the bank did not do nearly as well out of the jamboree as its Bretton Woods sibling, the IMF.

Since January Mr Zoellick has lobbied hard for Western governments to put aside a small fraction—0.7%—of their stimulus packages to help fund programmes in poor countries. But though there was endorsement in the G20 communiqué for the bank's proposed "Vulnerability Framework", there was no hard cash. The IMF, however, emerged from the meetings with a promised tripling of its capital. As the two Washington-based institutions head into their joint spring meetings on April 25th and 26th, the mood at the IMF is almost jolly. At the World Bank, however, there are murmurs of discontent.

Some think that Mr Zoellick blundered by focusing on the vulnerability fund, rather than securing a lump sum at the summit. But that may be unfair. The bank is one of the multilateral development banks that will help disburse up to $100 billion of new lending promised by the G20. Mr Zoellick himself says the bank does not need new capital but he does emphasise the need to turn "commitments into tangible financial support".

The bigger issue is that poor countries, when it comes to access to funds, complain that they have been pushed even further down the global pecking order because of a problem that was not of their making. They fear that rich countries' debt problems will mean that less money is available for poor ones. The bank's economists reckon that the crisis could push 53m more people into extreme poverty in poor countries, but some of those countries feel the bank itself could help more and will make that point loudly this weekend.

For instance, many of the "shovel-ready" projects in poor countries that the bank had intended to support in future years could be brought forward to this year. Nancy Birdsall of the Centre for Global Development, a Washington think-tank, believes that the bank should also temporarily suspend internal rules that prevent loans being disbursed quickly.

Even if that were to happen, plenty of problems lie ahead. The world's poorest countries rely mainly on interest-free loans or grants made through the International Development Association (IDA), an arm of the bank. IDA's funds are replenished every three years, and the latest round of commitments worth $41 billion, made in December 2007, determine its ability to lend until mid-2011. But America's promised contribution of $3.7 billion has yet to be approved by Congress. Getting this through may just have become trickier: the bank's Independent Evaluation Group recently found an "important weakness...in the complex of controls to manage the risk of fraud and corruption in operations supported by IDA". Yet another potential blow to the poor.

Pakistan's economy

Full fear and credit

Apr 23rd 2009
From The Economist print edition

Pakistan’s political instability brings macroeconomic calm

PAKISTAN is one of the few countries in the world that enjoys more macroeconomic stability today than it did on September 14th, the day before the bankruptcy of Lehman Brothers turned the world upside down. In those prelapsarian days Pakistan’s currency was tumbling; its foreign-exchange reserves covered barely two months of imports; and the cost of insuring its sovereign debt against default was almost 1,000 basis points (10%). Worst of all, the IMF had landed in Islamabad.

In the months since, Pakistan’s government has in effect conceded the Swat valley, a picturesque tourist spot, to the Taliban. It has suffered savage terrorist attacks on a police academy and the visiting Sri Lankan cricket team. It has also handed the political initiative to its rivals in the opposition party. But despite all this turmoil, it has found some macroeconomic steel.

In April the IMF released the second tranche of the $7.6 billion loan it offered Pakistan in November. The government’s reserves were above target; its fiscal deficit was below; and its borrowing from the central bank was contained. Pakistan has also raised electricity tariffs and reduced energy subsidies, despite popular protests. Indeed, its levy on oil products has become a big contributor to the public coffers. Emboldened by the drop in inflation, on April 20th the new central-bank governor even cut interest rates for the first time in six years.

The worry is that Pakistan has achieved stability without growth. In other emerging markets, the new, crowd-pleasing IMF has advocated counter-cyclical policies to combat the ill effects of global contraction. But Pakistan has committed itself to narrowing its fiscal deficit to 562 billion rupees ($7 billion), or 4.3% of GDP, by June. This target was set in October before the full horror of the world economic crisis had become apparent. Given the subsequent slowdown, the government’s revenue aims seem aspirational rather than feasible.

The danger was that the government would meet its target by cutting infrastructure spending, thereby undermining the country’s growth prospects. But Pakistan has one invaluable asset that is not quoted on its balance-sheet. It scares the rest of the world. Thus on April 17th a group of 31 countries, called the Friends of Pakistan, met in Tokyo and offered an extra $5.3 billion of friendliness over the next two years. Though the government is precarious enough to arrest the world’s attention, it is still—just—credible enough to earn its financial backing.

Economics focus

Not quite so SAFE

Apr 23rd 2009
From The Economist print edition

Is China souring on the dollar?

CHINA is America's largest creditor. Thanks to a policy of piling up foreign-exchange reserves and investing most of them in dollar assets, China's government bought around one quarter of the net increase in Treasuries over the past two years. But just as Washington needs to sell record amounts of debt to fund its soaring budget deficit and to bail out its banks, there are signs that Beijing's appetite for American debt may be shrinking.

According to official figures, China's reserves fell in January and February. Taking the first quarter as a whole they rose by just $8 billion, compared with $154 billion a year earlier. Chinese officials have voiced pointed public worries about the effect of America's massive fiscal and monetary expansion on the value of China's dollar holdings. In a high-profile essay, Zhou Xiaochuan, the governor of the People's Bank of China (PBOC), recently floated the idea of a global reserve currency. The combination of falling reserves and rising rhetoric has fuelled fears that China is turning its back on the greenback.

Follow the money

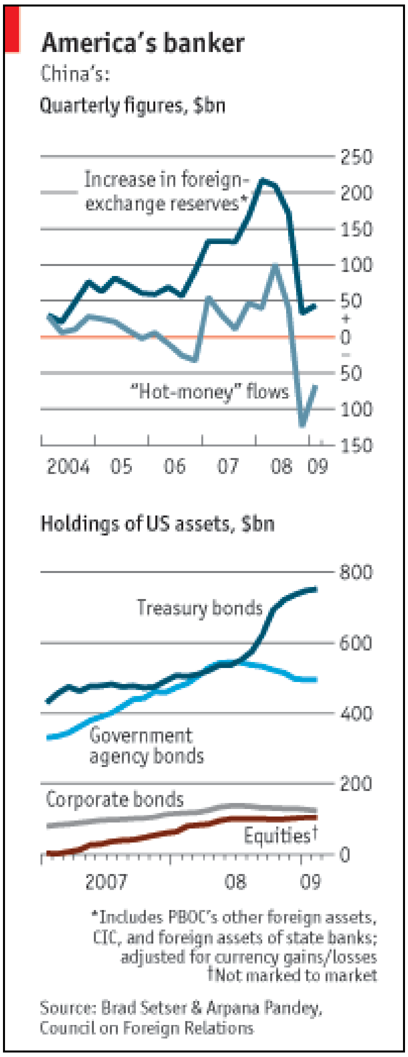
Assessing that risk means answering two basic questions. Is China buying fewer foreign assets? And is it diversifying away from the dollar? Few have delved deeper into the murky world of China's capital flows than Brad Setser of the Council on Foreign Relations in New York, and his analysis suggests a more complex picture than official statistics portray.

According to the official figures, China's foreign reserves are $1.95 trillion. But Mr Setser reckons that the true figure is around $2.3 trillion if hidden reserves are included, such as those of the China Investment Corporation (CIC), the country's sovereign-wealth fund, and the "other foreign assets" of the PBOC. Taking this wider measure of foreign-exchange reserves, and then adjusting for changes in the value of non-dollar reserves caused by swings in the dollar, Mr Setser reckons that China's total reserves rose by around $40 billion in the first quarter, only one-fifth of their increase in the first quarter of 2008. On the face of it, this represents a big drop in China's demand for foreign assets.

But official reserves are not the only potential source of Chinese demand for dollars. To see why, look at the country's balance of payments. China's current-account surplus is bigger than it was a year ago. That surplus along with a dollop of foreign direct investment gave China a net inflow of foreign exchange of well over $100 billion in the first quarter. If reserves rose by only $40 billion, then something else must account for the other $60 billion. Despite its strict capital controls, China is experiencing a large outflow of speculative private capital, or "hot money" (see top chart, below), largely that of Chinese investors. Just as such "hot money" inflows last year drove China's reserves up by more than the current-account surplus, so the outflows have now dampened reserve accumulation. But as long as China runs a large current-account surplus, it must, by definition be accumulating foreign assets. What seems to have changed, of late, is who is buying them. The "hot money" leaving China might still buy American Treasuries, or it could buy something else.

What of the idea that China's government has diversified into other currencies? Here, too, the statistics are hard to make sense of. The State Administration of Foreign Exchange (SAFE), which manages the country's reserves, does not disclose such details. America's Treasury reports on foreigners' investments in American securities, but these figures may understate China's stash because China buys some dollar assets though non-American intermediaries. For instance Mr Setser and his colleague, Arpana Pandy, estimate that since mid-2006, China has accounted for around 30% of purchases of American Treasuries though London. If these flows are added in to Washington's figures, China has about $1.5 trillion

invested in dollar assets, of which about half are in Treasuries. This is about 70% of China's total reserves. While that is down from over 80% in 2002, the drop largely reflects the weaker dollar, not a shift into other currencies.



SAFE has spent much of the past few years diversifying the types of dollar assets it holds. During 2007 it bought government-agency debt, ie, that of Fannie Mae and Freddie Mac, rather than Treasuries. In 2007 and 2008 it started to buy equities, just before the market tumbled. In the year to June 2008, China's holdings of American shares more than tripled to $100 billion. Before the financial markets collapsed last year, SAFE may have had over 15% of its portfolio in equities and corporate bonds, which is high for an official body—and has left it with huge unrealised losses. It is widely thought that SAFE does not mark to market, so official reserve figures conceal the hit. But it is sure to dwarf the more publicised losses from CIC's investments in Blackstone, a financial firm, and Morgan Stanley, an investment bank.

By many standards China's reserve portfolio has held up well during the crisis, because most of its reserves are still in long-term bonds which rose in price as interest rates fell; and the dollar so far has been strong. But embarrassing losses on riskier assets have led to a sharp shift in behaviour. Since mid 2008 SAFE has sold government-agency debt and corporate bonds. Its purchases of Treasury bonds have surged (see bottom chart) but of late they have been almost exclusively short-term bills. According to Mr Setser's figures, over the past three months China's American assets showed no growth for the first time in many years—despite the modest increase in reserves.

What does this all add up to? China is trying to have it both ways. It wants to lessen its dollar exposure, but it also wants to hold down the yuan. The picture has been temporarily clouded by shifts in "hot capital" flows, but so long as China runs a large current-account surplus, its reserves will rise. In order to keep the yuan weak against the dollar, a large chunk of those reserves will end up in greenbacks. Beijing's appetite may not match Washington's growing need for cash. But China cannot sour on the dollar without letting its own currency rise.

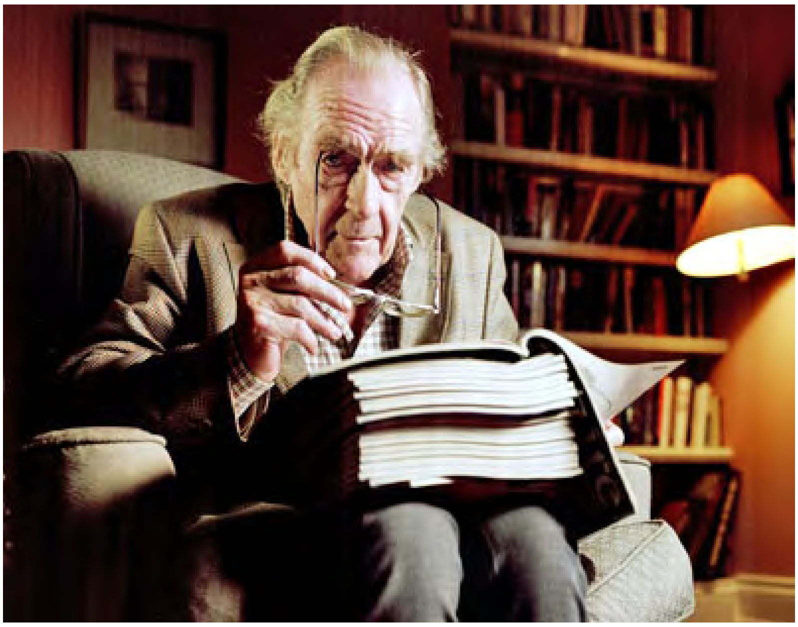
Sir John Maddox

The nature of Nature

Apr 23rd 2009
From The Economist print edition

The man who reinvented science journalism

Rex Features



WRITING any serious tribute to the science journalist and editor, Sir John Maddox, can only really start a long time after deadline, with the assistance of a cigarette and a glass of wine. Thus he famously began work on his editorials. Some were delivered so late that their first lines were being typeset before the last had been composed. But Sir John, who died on April 12th, was more than a hack with a little deadline difficulty. He was also a pioneer of modern science journalism.

In the course of transforming a parochial and withering publication called *Nature* into a globally influential scientific giant his instinct for publicity pushed science into British newspapers in a way that had not happened before. He also popularised the subject as a broadcaster on the BBC. And, perhaps most importantly, he trained a generation of writers who were seekers of scientific rationalism, but who never lost a sense of whimsy—and of whom several have sat in the science and technology office of *The Economist*.

When Sir John (as he then wasn't) arrived at *Nature* in 1966, having worked for a decade at the *Guardian*, the doyen of British science journals was in the doldrums. Its offices were piled with several thousand yellowing manuscripts. That was quickly sorted out. He introduced a system of peer review (asking outside experts to assess a paper's scientific worth), as well as the stamping on each manuscript of the date of its submission. He wanted *Nature* to be more like a newspaper and to be judged, among other things, by how fast it published scientific news. Manuscripts were also edited—shock!—for style and comprehensibility, as well as accuracy.

Anxious to put in something newsy, he started writing leaders—introducing opinion among the facts. He also hired a real reporter to sit alongside the manuscript editors, a beginner called Nigel Hawkes, who would go on to become science editor of the *Times*. Mr Hawkes was the first, but not the last, of the Maddox protégés.

Think global. Act local

One reason for all this activity was that it was clear to him when he arrived that *Nature* was losing ground to its competitor—an American publication called *Science*. During the 1950s and 1960s a shift in scientific power from Europe to America was benefiting *Science*. According to Alun Anderson, a Maddox protégé who went on to edit *New Scientist*, Sir John responded by globalising the magazine, opening offices in America, Japan and, in due course, many other parts of the world.

Globalisation, of course, requires global news. But Sir John was equal to that. Henry Gee, another protégé, recalls a trick that Sir John called the "Afghanistan Effect". "You write a little news story that says that nothing much has happened in Afghanistan, and people think 'Goodness! *Nature* has coverage of Afghanistan'."

He was also keen on embargoes, by which newspapers are given advance warning of the publication of a piece of research if they agree to delay writing about it until a given date, and make sure they mention the journal in which it is published. John Gribbin, a popular science author and yet another Maddox protégé, remembers the editor was particularly fierce about the embargo if he had an exciting paper. Sir John wanted *Nature* to make a splash with the story, and this caused friction with Fleet Street editors who wanted the scoop for themselves.

But he raised *Nature*'s profile, and was not afraid to get his hands dirty with public relations. He also beat a path to the laboratory door in search of good material, a practice that continues to this day with *Science*, *Nature*, *Cell* and other top-rank journals competing to acquire papers from the world's leading researchers.

Sir John's scientific rationalism, recalls David Dickson, a former news editor of *Nature*, led him into many controversial areas that further served to raise the magazine's profile. He led an assault on AIDS denialists and their supporters at the *Sunday Times*, and ended up in disputes over homeopathy, cold fusion and with Rupert Sheldrake, a parapsychologist. Another graduate of the Maddox school, Chris Anderson, the editor of *Wired*, remembers him as a "fearless" man, who would challenge anything and anyone whom he felt had left the principles of science behind in the pursuit of their own beliefs.

Although Sir John was a proponent of peer review, he could see how it might sometimes suffocate original thinking. It was for this reason that he never sent the manuscripts of Fred Hoyle, a controversial astrophysicist, for review. "It does not require a referee to tell whether it is a reasonable hypothesis that terrestrial life stems from interstellar bacteria," he wrote in a valedictory essay. Fashion, and a nose for news, played an important role in Sir John's universe, no matter that the man championed scientific rationalism.

The result is that *Nature* today is an outlet for the world's best scientific news and gossip, and offers strident leadership on public issues. However, the craziest person in the building is no longer the editor, and staff need no longer feel obliged to restrain him, says Alun Anderson.

Although *Nature* is a more organised and professional place these days, there is still a trace of Maddox present. When your correspondent was a junior reporter at *Nature* several years after he had departed, she was advised that her first editorial was best written late in the evening with a glass of whisky to hand. Sir John may have left the building, but his spirit lingers on.

Treating cancer

Illuminating surgery

Apr 23rd 2009
From The Economist print edition

A clever way of highlighting tumours to make them easier to remove

Alamy

The final cut?

A DIAGNOSIS of cancer is often followed by a prescription of surgery. Before chemotherapy, before radiation, the knife is frequently the oncologist's first line of attack. If done early and well, it has the potential to stop the disease in its tracks. Even if it does not, it is the best way for the doctor to get a feel for what he is dealing with, how extensive it is, and what to do next. But, whereas therapies and diagnostics for cancer have been evolving steadily in response to new biochemical knowledge, surgical techniques have remained surprisingly primitive.

What happens at the moment is that a surgeon roots around inside a patient, removes as much tumour as he can find, and hopes he got it all. He then sends what he has excised to a laboratory, where technicians sample all around the outside of the extracted mass to see if it is encapsulated by healthy tissue. If it is, the whole tumour has probably been removed. If not, the surgeon must go back in, and the time-consuming process starts again.

Roger Tsien and his colleagues at the University of California, San Diego (UCSD), are trying to halt this cycle by creating a luminous map for the surgeon to follow. Dr Tsien, who shared the 2008 Nobel prize in chemistry for his work on green fluorescent protein, has found a way to make cancer cells glow. That could help surgeons see precisely what to cut out and what to leave behind.

Getting fluorescent dyes to stick to cells in general is easy. Cells are covered in negative charges, so all you have to do is make the molecules you want to stick to them positively charged. Getting those molecules to stick only to tumour cells, though, is a different kettle of fish. To do so, Dr Tsien took advantage of enzymes called matrix metalloproteinases (MMPs), which cancer cells use to chew their way through connective tissue and other material. Few healthy cells make these enzymes, so they are a reliable marker of tumours.

To make use of the MMPs Dr Tsien attaches his fluorescent dye, along with some positive charges, to one side of a small hairpin-shaped protein molecule. The other side of the hairpin carries a collection of negative charges, so that the whole caboodle is electrically neutral. The secret is the composition of the hairpin's turn. This is a sequence of amino acids (the building blocks of proteins) that is particularly vulnerable to the cutting action of MMPs. When a dose of the new compound is injected, most of it washes out quickly. The only dye molecules that remain are those whose hairpins have been severed by MMPs, thus separating them from their negatively charged partners and allowing them to stick to the tumour cells whose enzymes liberated them.

And it works—at least in mice. With the help of Quyen Nguyen, a surgeon based at UCSD, Dr Tsien has tested the hairpin dye on mice that had had breast cancer induced in their bodies. Those animals that had been infused with the dye before surgery had a five-fold better survival rate than those which had not. In other words, the glow allowed Dr Nguyen to see the tumours better and remove them more accurately, thereby preventing the disease from spreading.

Dr Tsien and his team believe their targeted dye has huge potential. They have already put it to use in magnetic-resonance imaging by combining it with gadolinium, a metal employed as a contrast agent in this sort of body scanning. Used this way, the dye does more than just provide guidance to the surgeon during the procedure—it highlights tumours both pre- and post-operatively. It can also show whether tumour cells have crept onto nerve fibres, something that is now left to a biopsy or a surgeon's best guess. And Dr Tsien has even modified the dye to respond to other molecules, such as a blood-clotting

factor called thrombin. The result lights up those arterial plaques most at risk of becoming dislodged and causing a heart attack or stroke. A spotlight on disease, as it were.

Robotics (I)

Polyphemus does the hoovering

Apr 23rd 2009
From The Economist print edition

One-eyed robots may soon be coming to a living room near you

THE Cyclopses, according to mythology, were a race of bad-tempered and rather stupid one-eyed giants. Not, perhaps, a great portend for a new generation of robots. But Andrew Davison, a computer scientist at Imperial College, London, thinks one eye is enough for a robot, provided its brain can think fast enough.

For a robot to work autonomously, it has to understand its environment. Stereoscopic vision, integrating the images from two “eyes” looking at the same thing from different angles, is one approach, but it involves a lot of complicated computer processing. The preferred method these days, therefore, is SLAM (Simultaneous Localisation And Mapping), which uses sensors such as laser-based range finders that “see” by bouncing beams of light off their surroundings and timing the return.

Dr Davison, however, wants to replace the range finders, which are expensive and fiddly, with a digital camera, which is small, cheap and well understood. With this in mind, he is developing ways to use a single, moving video camera to create continually updated 3D maps that can guide even the most hyperactive of robots on its explorations. His technique involves collecting and integrating images taken from different angles as the camera goes on its travels. The trick is to manage to do this in real time, at frame rates of 100 to 1,000 per second.

The shape of the world pops out easily from laser data because they represent a direct contour map of the surrounding area. A camera captures this geometry indirectly and so needs more (and smarter) computation if it is to generate something good enough for a self-directing robot. The answer is a form of triangulation, tracking features such as points and edges from one frame to the next. With enough measurements of the same set of features from different viewpoints it is possible, if you have a fast enough computer program, to estimate their positions and thus, by inference, the location of the moving camera.

Developing such a program is no mean feat. In the milliseconds between successive frames, relevant information from each fresh image must be extracted and fused with the current map to produce an updated version. The higher the frame-rate, the less time there is to do this work. Rather than throwing more computing power at the problem, though, Dr Davison is using standard processors and concentrating on making his programs super-efficient by analysing the bottlenecks within them and devising ways to cut the number of computational steps. As a result, he and his colleagues have recently been able to show this new form of SLAM working at 200 frames a second on a camera tossed from hand to hand, using just a laptop computer to run the program.

Rates as high as this can track fast movement, so single-camera eyes could be built into flying or jumping robots used to explore areas such as collapsed buildings that are too dangerous for people. Alternatively, the same programs can run at standard webcam speeds of 30 or fewer frames a second, bringing camera-based SLAM to mobile phones, games consoles and even vacuum cleaners.

Some well-known games firms are exploring possible uses of the technology, for example to generate a 3D map of a player’s room so that it can be incorporated into the game. Dr Davison is also talking to a European company interested in making smart, self-guided vacuum cleaners. If, together, they can create an affordable, dust-fighting robot that can see where it is going (and won’t throw boulders at its rivals), that would put the one-eyed myth to rest.

Robotics (II)

Look, no wires

Apr 23rd 2009
From The Economist print edition

A tiny, levitating robot takes to the air

Illustration by David Simonds

Correction to this article

SQUADRONS of robotic machines have taken flight in recent years, ranging from unmanned aerial vehicles which patrol in Iraq and Afghanistan to experimental machines not much bigger than insects. But it remains hard to shrink engines, batteries, mechanical actuators and control electronics to the point where they are small and light enough to fly without impairing their performance. It would be nice, therefore, if all the on-board paraphernalia of propulsion and control could be dispensed with, leaving an unencumbered device that is still capable of directed flight.

That is exactly what Behrad Khamesee and his colleagues at the University of Waterloo, in Ontario, have managed. They have built a micro-robot that levitates, rather like a Dalek in "Dr Who". And instead of having an old sink-plunger doubling as its arm, their robot has a useful set of grippers.

The researchers use magnetic levitation to lift their robot, which is a mere 6mm tall. The process, which relies on magnetic fields attracting or repelling each other, is more usually applied to large machines such as maglev trains, and then with some kind of guide rail or tether to prevent the machine from drifting too far off track. Dr Khamesee's robot, however, is completely untethered and can be positioned to an accuracy measured in a few thousands of a millimetre.

The drive and control mechanism is an array of electromagnets that create a three-dimensional parabolic magnetic field around the robot. The interaction between this field and the permanent magnets from which the robot is constructed allows it to levitate. It is held in position using the electromagnets to concentrate the field to a focal point, much as a lens focuses light, says Dr Khamesee. By controlling the current in the array the focal point can be moved around, and with it the robot. The position of the robot is monitored by lasers and a camera, which are connected to a computer that controls the field to keep the robot steady.

Having got their robot to levitate, the researchers wanted to make it capable of work. Their first attempt used a set of grippers made from a "memory" metal, an alloy that changes shape when heated by an electric current and then returns to its original form when the current is switched off. But the watch battery the robot needed to carry around to do this quickly ran flat, so the team switched tack. Now, the grippers are made from a polymer whose thermal-expansion properties cause the jaws to open when part of the structure is heated with an external laser. The jaws close when the laser is turned off and the material cools.

Dr Khamesee thinks tiny levitating robots of this sort could manipulate small components and biological samples. Often, these manipulations are carried out in closed chambers at carefully maintained pressures and temperatures. They can also involve hazardous materials. By levitating inside such an environment the micro-robot would leave no footprints, so to speak, and need no connecting wires.

The team are now working on improving the robot's precision and expanding the volume in which it can operate. They are also looking at the possibility of using the system to control even smaller robots that could be used within the body, for drug delivery or microsurgery. Imagine opening your mouth and watching one levitate inside.

Correction: the process for lifting the robots uses magnetic attraction, as well as the magnetic repulsion to which we originally referred. And the new grippers are made from a polymer, not a metal. Sorry. These corrections were made on April 24th 2009.

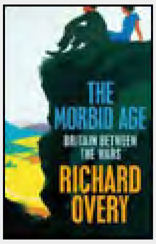
Britain between the wars

A sense of dread

Apr 23rd 2009
From The Economist print edition

The period between the two world wars was a time of anxiety and foreboding. Much like our own age—only more so

The Morbid Age: Britain Between the Wars
By Richard Overy



Allen Lane; 522 pages; £25

Corbis

A FEW weeks ago, the British government's chief scientific adviser, John Beddington, made a bloodcurdling speech about the horrors lying in wait for us. By 2030, he said, the world will be facing a perfect storm of food, energy and water shortages caused by population growth and exacerbated by climate change. James Lovelock, the creator of the Gaia theory, receives extensive, largely uncritical, coverage when he predicts that global warming will have wiped out 80% of humankind by the end of the century. In the meantime, we are living through what many people believe (and some hope) to be the final collapse of capitalism, while attempting with only limited success to fight a “global war on terror” against an enemy that threatens to destroy “our way of life”.

There is nothing new in society being gripped by anxiety about the present and pessimism about the future. In his latest book, Richard Overy, a distinguished British historian of the second world war, has

turned his attention to the period between the wars when, he argues, the presentiment of impending disaster was even more deeply felt (and perhaps with better reason) than it is today. Indeed, Mr Overy sets out to show that it was a uniquely gloomy and fearful era, a morbid age that saw the future of civilisation in terms of disease, decay and death.

The author concentrates on Britain. This is partly because it saw itself (and was seen by others) as the most powerful expression of modern Western civilisation and partly because it was a liberal, open society in which ideas flowed freely and reached an ever-larger audience of concerned and educated citizens. Although Britain was relatively fortunate compared with other developed countries—its economy suffered less during the Great Depression and it escaped the intense social upheaval, political extremism and civil war that blighted lives elsewhere in Europe—the sense of doom was as strong there as anywhere. Nor did Britons think of themselves as being in any way isolated from the many violent intellectual currents of the time.

If the cataclysm of the first world war had destroyed any belief in the immutability of a civilisation based on liberal, progressive British values, the origins of the morbid age can also be found in developments in the natural and social sciences that occurred well before 1914. Marx had foretold that capitalism would eventually be destroyed by its own contradictions. Darwin's theories of natural selection and genetic inheritance had spawned fears about racial decline. Freud and psychoanalysis had exposed unconscious, primitive impulses lurking deep within all of us. Similarly, advances in chemistry, physics and mechanical engineering had produced weapons that made possible slaughter on a scale never before experienced.

By the 1920s, with the advent of mass media and the associated rise of the public intellectual—figures such as Arnold Toynbee, Julian Huxley, Cyril Burt, John Maynard Keynes and Marie Stopes—these and other ideas began to exercise a powerful grip on the popular imagination. Making extensive use of primary sources, Mr Overy examines each in turn: the loss of faith in the free-market system caused by rising unemployment and the belief among a generation of British socialists influenced by an outspoken couple, Sidney and Beatrice Webb, that the answer was an ameliorated form of Soviet-style planning; the growing fashion for psychoanalysis, its apparent challenge to reason and its effect on the artistic imagination; and, perhaps most shockingly for readers today, the corrupted Darwinism that led to the rise of the eugenics movement and attempts by apparently respectable people to pass legislation to allow the forcible sterilisation of "mental defectives".

The second half of "The Morbid Age" concentrates on the British reaction to political turmoil in Europe and the arrival on the scene of Hitler. Mr Overy charts the growth of the hugely popular pacifist and anti-war movements, such as the League of Nations Union, which in 1935 through an unofficial plebiscite attracted the support of 12m adult voters. Whereas many were attracted to the idea of a benign world government as an alternative to the staleness and cynicism of conventional politics, Britain was fortunate that only a few saw salvation in the perverted Utopianism of Soviet communism and fewer still in fascism, particularly after the brutalities of the Spanish civil war. Mr Overy observes: "In this great melodrama Hitler's Germany was the villain; democratic civilisation the menaced heroine; the many forces of progressive thinking the simple-minded but courageous hero; the Soviet Union the hero's bold but not altogether trustworthy accomplice."

During this period something strange happened. After the horrors of the first world war, many people were convinced that another global conflict would unleash forces of barbarism that decaying liberalism would be powerless to resist and that the inevitable result would be the dawning of a new dark age.

But as the prospect of war drew closer, pessimism and defeatism were replaced with a grim determination to confront the manifest evil of Nazism. In the three years between the crises in Spain and central Europe, Mr Overy writes, "the balance between saving civilisation through peace and saving civilisation by war swung decisively in favour of the latter." When war eventually came, it was for many people almost a relief—a climax in the patient's condition after which would come either death or recovery.

"The Morbid Age" is history at its best. It tells us not just what people did, but what were the social and intellectual influences that caused them to do what they did. With elegance and erudition, Mr Overy opens a window into the mind of a generation—a generation with anxieties both very different from and yet surprisingly similar to those of our own today.

The Morbid Age: Britain Between the Wars.
By Richard Overy.
Allen Lane; 522 pages; £25

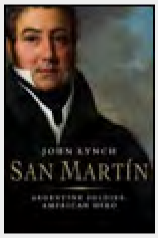
José de San Martín

Argentine soldier, American hero

Apr 23rd 2009
From The Economist print edition

IT IS only a slight exaggeration to say that José de San Martín has become the forgotten man of South American independence. In recent years the cult of Simón Bolívar, his Venezuelan collaborator and rival, has been obsessively promoted by Hugo Chávez's petrodollars and by the more puerile left. This has overshadowed the other great military leader of the fratricidal wars by which Spain's hegemony over the American continent was broken. Yet San Martín is still revered as the liberator in Argentina and Chile, as well as in Peru where Bolívar's eventual triumph would have been impossible without the other man's pioneering invasion.

San Martín: Argentine Soldier, American Hero
By John Lynch



Yale University Press; 265 pages; $35 and £25

Three years ago John Lynch, a British historian, published an impeccably balanced biography of Bolívar. Now, on the eve of the bicentenary of the independence movements, he sets out to rescue San Martín from his relative obscurity. This is a harder task, for San Martín was by nature reserved. Born in the Argentine interior, the son of a Spanish colonial official, he was above all a professional soldier. Having moved to Spain as a child, he served for two decades in its army, rising to lieutenant-colonel of cavalry and fighting for three years against Napoleon's French troops. In 1812 he switched to fighting against Spain, and sailed to Buenos Aires.

San Martín's unique talents were "an ability to think big and a genius for organisation". He quickly concluded that the key to securing the independence of the United Provinces of the River Plate (as Argentina was then called) lay in the conquest of Peru, the bastion of Spanish power. Having sought the obscure post of governor of Cuyó, the area around Mendoza, he used this as the base to recruit and train an army. In 1817, in a supreme feat of generalship, he led his 5,000 troops over high Andean passes to Chile, gathered them together again and fell upon the Spanish forces, defeating them at Chacabuco.

Three years later he embarked his army in ships assembled by Lord Cochrane, a brilliant, if self-serving, British naval commander operating as a privateer, and landed in Peru. But Peru was a divided society, and San Martín believed his army of 4,500 was too small to defeat royalist forces roughly double its size. Declaring himself "protector" of Peru, he spent a frustrating two years trying to persuade the country to liberate itself. With his army disintegrating through inaction and disease, San Martín sought reinforcements from Bolívar, whom he met in Guayaquil in June 1822.

Much is often made of the clash between Bolívar's republicanism and San Martín's avowed belief that only monarchy could provide order in independent South America. Mr Lynch argues that both men were enlightened despots. Bolívar ended up favouring a president for life, with power to name his successor; monarchy in all but name. What was really at stake in Guayaquil, as San Martín accurately put it, was that "there is not enough room in Peru for Bolívar and me." And Bolívar had more troops, the product of his political power over greater Colombia. Showing a lack of personal ambition rare among his contemporaries, San Martín promptly withdrew. He spent the rest of his long life in voluntary exile in Europe.

A decent, moderate man, San Martín believed dictatorial government was essential in South America, but shrank from imposing it. Bolívar suffered no such restraints. San Martín may have been too cautious in Peru. But his biggest weakness was that, as he admitted, "I have a poor head for politics."

Mr Lynch is reluctant to go beyond the documentary evidence. Thus his account of the crucial Guayaquil encounter is sparse and somewhat anti-climactic. But his book will provide a valuable corrective to the more fanciful outpourings of Bolivarianism which can be expected in the bicentennial junketing. As Mr Lynch concludes, though San Martín's achievements were different to those of Bolívar, they were "not inferior".

San Martín: Argentine Soldier, American Hero.
By John Lynch.
Yale University Press; 265 pages; $35 and £25

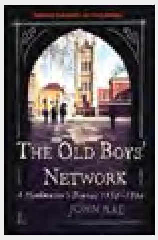
John Rae's diaries

The old boys' network

Apr 23rd 2009
From The Economist print edition

THESE entertaining journals are ill-served by their title. The dust jacket and the title page carry different dates, and both are wrong. More importantly, John Rae, who died in 2006, would have been outraged by the implication that he was a typical “old boy”. A non-conformist by upbringing, educated at an unfashionable school, with a modest degree from Cambridge, where he won half-blues for swimming and water polo, he rejoiced in being an outsider, a maverick and a source of irritation to conventional, rugby-playing headmasters who disliked his “vulgar bounce and salesmanship”.

The Old Boys’ Network: A Headmaster’s Diaries 1970-1986
By John Rae



Short Books; 352 pages; $26.75 and £17.99

Buy it at
Amazon.com
Amazon.co.uk

The handsome, charming, ambitious Rae may have been principally interested in selling himself, but he was devoted to Westminster, arguably London’s finest private school, and he served it well at a difficult time. In April 1976, at an unpublicised meeting of eight major public schools, the heads dined in the warden’s lodgings (dining is an essential part of such meetings) and discussed the threats posed by “rising fees, falling numbers and political hostility”. The unspoken agenda was that their schools must survive even if others went to the wall. While Rae was at Westminster the number of pupils increased by a third and girls were successfully integrated into the sixth form.

Headmasters must satisfy the conflicting demands of governors, colleagues, parents and pupils. Rae had his problems with interfering governors and unsatisfactory or disaffected teachers (one calls the boys “bastards”, another sounds off about Saturday-morning school), and he took trouble to prevent an alliance between them. However, most of his time was spent dealing with anxious or dissatisfied parents and ill-behaved boys. (No mention of naughty girls.)

His heart lay with his pupils. Time and care were devoted to selecting entrants to the school and to ensuring that they went on to the right Oxbridge college. In a capital city, with clever, independent-minded, day and weekly-boarding pupils, Westminster was peculiarly at risk from student rebellion and the easy availability of drugs. Rae dealt fairly and firmly with offenders; and noted how often the parents were separated and the father absent.

Rae considered stamina to be the key to success as a headmaster and he possessed remarkable energy. He enjoyed Westminster’s unique situation at the heart of things, and made light of IRA bombs. There is lunch at Buckingham Palace (good for morale), dinner at Downing Street, encounters with five prime ministers, with the Dalai Lama, Len Hutton, Isaiah Berlin and John Cleese. He teaches history, writes books, chairs the Headmasters’ Conference (his qualifications do not compare with those of the member who killed a German with his bare hands), patrols the yard on the last night of term. Rarely does he flag. One evening an avuncular boy carries him off to the pub. Another time his wife is dispatched to a dinner party alone whilst he slips out to see “The Sting”. There is little reference to family, and various deaths are recorded coolly and without sentimentality. As is his own retirement: “no frog in the throat”.

The Old Boys’ Network: A Headmaster’s Diaries 1970-1986.
By John Rae.
Short Books; 352 pages; $26.75 and £17.99

New fiction

Philipp Meyer's “American Rust”

Apr 23rd 2009
From The Economist print edition

Illustration by Daniel Pudles

American Rust
By Philipp Meyer

Spiegel & Grau; 384 pages; $24.95. Simon & Schuster; £12.99

Buy it at
Amazon.com
Amazon.co.uk

SET in America’s crumbling industrial heartland, Philipp Meyer’s first novel, “American Rust”, is so timely that it makes painful as well as enjoyable reading. The novel is a paean to the end of empire.

Though his father Henry never told him, Isaac’s boyhood IQ was measured at 167—genius level. He is probably smarter than his older sister, who escaped her withering rural roots for Yale. Yet at 20 Isaac is still trapped in the small town of Buell, Pennsylvania, taking care of his father. Henry was disabled by an accident in one of the valley’s poorly maintained steel mills, nearly all now closed; indeed, some of the only remaining work in Buell is tearing down these redundant structures. After stealing $4,000 from his father, Isaac plans to make his own life at last in California.

On the eve of his departure, Isaac gets together with his best friend Billy Poe, a former high-school football star who has also failed to heed the edict that at 18 you should flee the rust belt altogether. Sheltering from a rainstorm in an abandoned factory, the boys encounter a trio of tramps. In a fateful confrontation, Isaac kills one of the vagrants to save his friend. Unaware that Poe will end up taking the rap for the murder, Isaac hightails it by rail. Meanwhile, Poe samples another of America’s decrepit institutions: its prison system.

Mr Meyer’s voice is assured, and the story crackles with narrative tension. He develops his characters with impressive psychological and sociological insight, observing astutely that “there was something particularly American” about “blaming yourself for bad luck—that resistance to seeing your life as affected by social forces, a tendency to attribute larger problems to individual behaviour.” Meyer himself sees these larger forces all too clearly, and it is his portrayal of America’s devastated industrial base that is likely to get this novel much attention: “You could not have a country, not this big, that didn’t make things for itself. There would be ramifications eventually.” The author delineates the inexorable welfare dependency, petty crime and drug and alcohol abuse that follow when the infrastructure of steady employment implodes. The picture is grim, but masterfully painted.

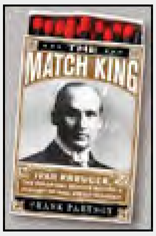
American Rust.
By Philipp Meyer.
Spiegel & Grau; 384 pages; $24.95. Simon & Schuster; £12.99

Ivar Kreuger, the match king

A likeable rogue

Apr 23rd 2009
From The Economist print edition

The Match King: Ivar Kreuger, the Financial Genius Behind a Century of Wall Street Scandals
By Frank Partnoy



PublicAffairs; 288 pages; $26.95. Profile Books; £18.99

Buy it at
Amazon.com
Amazon.co.uk

ONLY occasionally does literature throw up great swindlers, like Anthony Trollope's Augustus Melmotte. Real rogues are far more common. A new biography of Ivar Kreuger, who perpetrated perhaps the biggest financial scandal of the 20th century, provides a fascinating insight into how high society falls prey to such colourful characters.

Kreuger's story is uncannily relevant today. When the dapper, 42-year-old Swede sailed aboard a luxury liner into New York in 1922, he could sense the mood of euphoria beginning to grip Wall Street. But he didn't just take advantage of it like a fly-by-night Charles Ponzi. He helped define his era, accompanied by friends such as Greta Garbo and Herbert Hoover.

The product on which he built his fortune, the Swedish safety match, kept cigarettes smouldering through the jazz age. Hence his sobriquet, the Match King. But that was just for starters. Frank Partnoy, a well-regarded academic and writer on contemporary white-collar crime, explains in detail how Kreuger used the laissez-faire spirit of the time to persuade cash-strapped European governments to grant him match monopolies, offering them loans financed by American investors in return. He had a genius for financial innovation and an utter disregard for accounting niceties, making him a forefather of some of the financial scandals of the 21st century. Investors didn't care much about the lack of transparency. He raised $154m from them in America, enabling him to replace banks such as the House of Morgan as a source of global finance. That caused bitter consternation. When he made a $70m loan to the French government and wiped Jack Morgan's eye, the international media "compared him to the Medicis and Fuggers, history's other great private funders of governments," Mr Partnoy writes.

The author can at times appear gushingly over-impressed by his subject. But in some ways he is setting the record straight. When Kreuger's suicide was reported in 1932, and he was discovered to have forged holdings of Italian treasury bills, his empire collapsed and he was vilified around the world. It knocked the last shred of confidence out of the Depression era. Yet some of the businesses he founded or invested in, such as Swedish Match and Ericsson, are still standing, and his American investors could have recouped some of their losses if they had held out long enough.

Mr Partnoy is less convinced by the claims of Kreuger's long-standing champions in Sweden that he did not take his own life but was murdered. In defence of Kreuger, though, he makes a point worth remembering as people seek villains to blame for today's financial mayhem. There is always a fine line between sharp business practices and being ethical. In his "alegal" pursuit of profit, Kreuger was egged on by his directors, his investment bankers, his auditors and, of course, his investors. When times were good, they turned a blind eye to his foibles. When they wanted someone to blame, they turned on him. But there was (and there usually is) plenty of blame to go round.

The Match King: Ivar Kreuger, the Financial Genius Behind a Century of Wall Street Scandals.
By Frank Partnoy.
PublicAffairs; 288 pages; $26.95. Profile Books; £18.99

Merce Cunningham

Lord of the dance

Apr 23rd 2009 | NEW YORK
From The Economist print edition

Merce Cunningham, still hard at work at 90

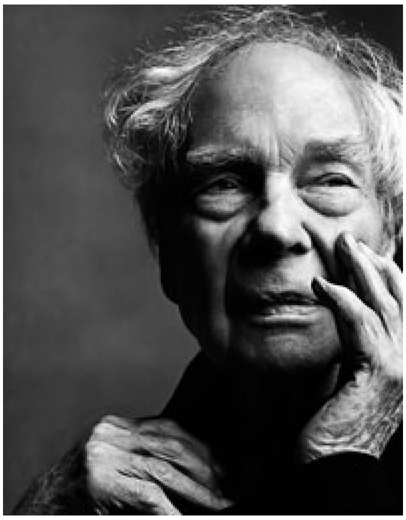
HUMAN movement has limitations, “but within the limits, the variety is endless.” So says Merce Cunningham, the man known as America’s Nijinsky. Mr Cunningham has spent much of his long life choreographing dance pieces that tease and test these restrictions. His dancers waddle, with torsos torqued and arms spread, and then extend a pointed leg and pause. Or they swivel their knees, leap and then bend at the waist in a sudden bow. His moves are awkward and sublime, full of imagination and possibility. The body in space is his laboratory, always ripe for experimentation.

All of Mr Cunningham’s nearly 200 works exult in dance for its own sake, without the trappings of narrative. “Movement by itself is what absolutely touches me,” Mr Cunningham has said. He has done more than any other choreographer to reinvent what it means to dance, and he is still surprising audiences with new work. To celebrate his 90th birthday this month, the Brooklyn Academy of Music hosted the world premiere of “Nearly Ninety”. A 90-minute piece set against a loud improvisational score, it succeeded in being youthful, fresh and weird all at once.

Dressed by Romeo Gigli in crisp white and blue, the troupe moved with lively, disciplined purity. In Mr Cunningham’s duets, male and female dancers trade moments of power and vulnerability, of falling and being caught. A series of trios offered unexpected combinations of robotic arms and strong kicking legs. Torsos rippled and legs snapped high in commanding leaps. For him the drama is in contrasts, the meaning in ambiguity. These are kinetic sculptures that can and should be seen from any angle.

Mr Cunningham has spent a career trusting his collaborators. As with all his premieres, the music, costumes, lighting and set design of “Nearly Ninety” came together for the first time only in the dress rehearsal. This is how the choreographer ensures the independence of his dance moves. He has crafted his pieces in silence ever since John Cage suggested it in the early 1940s. Their partnership, both professional and romantic, lasted until Cage died in 1992. Cage also inspired him to use games of chance to help set the order of his dances. Mr Cunningham continues to roll dice and flip coins to make certain choreography decisions, explaining that this helps him avoid cliché.

AP



Hands of time

For this new work, the choreography was set against an edgy soundscape of grinding guitars and industrial noise, composed and performed by John Paul Jones (formerly of Led Zeppelin), Takehisa Kosugi and Sonic Youth, a rock band. At times the music sounded like drag-racing cars, then like gigantic buzzing bees, the dancers emerging from this sound cloak in quieter moments to reclaim their primacy.

Stage design for Cunningham productions tends towards minimalism. When he collaborated with artists such as Robert Rauschenberg and Jasper Johns, sets were often a big painting and artful lighting. But for this piece Trevor Carlson, the Merce Cunningham Dance Company’s executive director, commissioned a scene-hogging structure from Benedetta Tagliabue, an Italian architect, to house and elevate the musicians. Her luminous spaceship-crystal design, although interesting, often dwarfed the dancers. Together with Franc Aleu’s video projections, the stage was far busier than it needed to be.

Confined now to a wheelchair, Mr Cunningham spends less time than he used to liaising with his collaborators, and it is starting to show. The weaknesses of “Nearly Ninety” are mostly the result of decisions made by other people, which has led to concerns about what will happen to the company when Mr Cunningham is no longer there to guide it. Mr Carlson says that he and the company’s board have been working with Mr Cunningham on a plan that will respect his legacy and keep as much of his work

intact and available to the public as possible. “We won’t follow the same unfortunate path that the [Martha] Graham company followed, by any means,” Mr Carlson explains, referring to the bitter legal battle over the rights to Graham’s dances after her death in 1991. The plan will be announced later in the summer. For the moment Mr Carlson is giving nothing away. “But it’s also nothing like any other single choreographer company has ever done before,” he adds

Meanwhile, Mr Cunningham still thrives on the drama of performance. With a mess of white hair and dressed in a black velvet suit, he smiled broadly as he thanked the packed theatre for joining him on his birthday, April 16th. “Perhaps”, he said, “I gave you something you haven’t seen before.”

“Nearly Ninety” will be performed in Madrid from April 30th to May 3rd, and then travel to Champaign-Urbana, Paris, Berkeley and London

Eddie George

Apr 23rd 2009
From The Economist print edition

Lord George of St Tudy, British central banker, died on April 18th, aged 70

Getty Images

THE ability to excite is not a quality highly prized among central bankers, and certainly not in Threadneedle Street, where the Old Lady synonymous with the Bank of England has from her first depiction in 1797—on the point of ravishment at the hands of a lustful prime minister—abhorred anything approaching a shock. The succession of governors charged with guarding her virtue have accordingly been chosen chiefly with safety and sound judgment in mind. Eddie George offered these in abundance.

He was not, however, an obvious choice. The son of a postal clerk, he could not be considered a grandee. He was not even a great economic mind, having gained only second-class honours in the dismal science at Cambridge. Neither was he strictly a man of the world. He had done his national service in the air force, and there learnt Russian, but his career from the age of 23 had been spent within the sparsely windowed walls of the Bank of England, except for secondments to the Bank for International Settlements and then the IMF. Not for him the rough and tumble of the financial marketplace.

Still, Lord George had interests and accomplishments to supplement his training. Whereas his predecessor, whose heart was in the country, had enjoyed grappling with the swarms of bees he kept on a roof above the bank, “Steady Eddie” preferred a rubber of bridge, a game, he said, which taught him that weak hands could still be winners, just as strong ones could end in defeat. He also enjoyed sailing, which may have taught him how to proceed in the face of headwinds, obliquely harnessing the opposing blasts of bankers, politicians and colleagues to steer a forward course.

He did this with great skill, advancing within the bank despite incidents that might have done for a lesser figure. One was the collapse in 1991 of the Bank of Credit and Commerce International, which led to accusations of lax regulation. Another was the pound’s ignominious defenestration from the European exchange-rate mechanism in 1992. Whatever the embarrassment, these did him no harm in the end, and long before he formally took over in 1993 he was largely running the bank.

A rather too dignified striptease

He saw the need to be open, though, especially when, to general surprise, a new Labour government in 1997 granted the bank the right to set interest rates independently. This task actually fell to a committee, chaired by Lord George, which duly published the minutes of the meetings in which it chose the rates deemed appropriate for hitting the government's inflation targets. Interviews and press conferences were accepted as necessary. At last the Old Lady was revealing herself.

Lord George was a moderniser, and nothing brought the bank up to date better than giving it independence over monetary policy. Yet he was both more and less than a moderniser. More, because what he really wanted was to make the bank efficient, in the sense that Walter Bagehot, an early editor of *The Economist*, used the word. He wanted to turn it into a part of government with the motive force to make things happen. When Lord George joined the bank, it had been more "dignified"—an institution whose governor had the use of a Rolls-Royce, whose doormen wore pink tail coats, and whose purpose was nobody knew quite what. Lord George realised the bank had to be demystified if it was to become a place of real seriousness.

Yet he was also less than a moderniser. He adored the bank, with an attachment that bordered on sentimentality. He hated paying the price for independence, whether it was the loss of banking supervision, which almost brought his resignation, the removal of the debt-management operations of the bank or the contracting out of the business of printing the banknotes. He could not bear to see the bank lose any of its roles, however much he might understand the logic of it doing so. He got rid of the Rolls, but the pink coats live on.

And he has been vindicated, many would say, at least about the loss of supervision. The tripartite system that replaced the bank's oversight has been a failure. But it is possible that the bank was still not the best institution to act as regulator. Lord George's belief in it was born of his own intimate knowledge of what he called the plumbing. Like his friend Gerald Corrigan of the New York Federal Reserve, he knew the workings of the system inside out, and his fondness for it was like an engineer's fondness for the machinery he has long looked after and lovingly come to understand. He recognised the grunts and wheezes of the financial pistons, the hissing of a dwindling tap stock, the twitching of a troublesome yield curve.

At the end of his second, and final, term in 2003, Lord George could say he had helped give Britain more than 40 successive quarters of economic growth. Would he have continued as well? No one could doubt his grit or calm, even if he owed some of his steadiness to a prodigious consumption of cigarettes. He was also blessed with intuition and an invaluable ability to learn from experience. He certainly helped to demystify, if not quite de-dignify, the bank. And he had good luck, at least in the timing of his guardianship of the Old Lady's honour. No bad thing in a general, nor in a central banker.

Overview

Apr 23rd 2009
From The Economist print edition

The IMF forecast that the **world economy** would shrink by 1.3% in 2009, the first global fall in 60 years. In January the fund predicted growth of 0.5%.

Japan's customs-based exports fell by 45.6% in the year to March. The rate of decline slowed, raising hopes that the export slump may be bottoming out. Imports fell by only 36.7% on a year earlier, which caused Japan's monthly trade surplus to shrink to 10.9 billion yen ($112m) last month from 1.1 trillion yen in March last year.

Producer prices in **Germany** fell by 0.5% in the year to March, the first fall since February 2004 and the biggest since September 2002. However, the ZEW index of German investor and analyst expectations, a widely used measure of investor confidence, rose to 13 in April from -3.5 a month earlier.

Britain's annual consumer-price inflation rate fell to 2.9% in March from 3.2% in February. But retail prices, unchanged in February, fell by 0.4% in the year to March.

Sweden's central bank cut its benchmark interest rate by half a percentage point, to 0.5%. **India's** Reserve Bank reduced the repurchase rate to 4.75%, and shaved a quarter of a percentage point off the reverse repurchase rate, to 3.25%. It was the sixth cut in as many months.

Consumer prices in **Australia** rose by 2.5% in the first three months of this year compared with the same period in 2008. Prices rose by 0.1% over the previous quarter.

Output, prices and jobs

Apr 23rd 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−0.8 Q4	−6.3	−2.7	+1.4	−12.8 Mar	−0.4 Mar	+4.0	−0.8	8.5 Mar
Japan	−4.3 Q4	−12.1	−6.5	+0.4	−38.4 Feb	−0.1 Feb	+1.0	−1.0	4.4 Feb
China	+6.1 Q1	na	+6.0	+7.0	+8.3 Mar	−1.2 Mar	+8.3	−0.8	9.0 2008
Britain	−2.0 Q4	−5.9	−3.5	+0.3	−12.5 Feb	+2.9 Mar§	+2.5	+1.2	6.7 Feb††
Canada	−0.7 Q4	−3.4	−1.9	+1.6	−7.8 Jan	+1.2 Mar	+1.4	+0.6	8.0 Mar
Euro area	−1.5 Q4	−6.2	−3.4	+0.2	−18.4 Feb	+0.6 Mar	+3.6	+0.4	8.5 Feb
Austria	+0.5 Q4	−0.8	−2.0	+0.3	−6.5 Jan	+0.8 Mar	+3.5	+0.6	4.5 Feb
Belgium	−0.8 Q4	−6.5	−2.7	+0.3	−17.9 Jan	+0.6 Mar	+4.4	+0.7	11.2 Feb‡‡
France	−1.1 Q4	−4.4	−2.7	+0.3	−15.5 Feb	+0.3 Mar	+3.2	+0.3	8.6 Feb
Germany	−1.7 Q4	−8.2	−4.3	+0.3	−20.3 Feb	+0.5 Mar	+3.1	+0.3	8.1 Mar
Greece	+2.4 Q4	+1.2	−3.4	−0.4	−4.6 Feb	+1.3 Mar	+4.4	+0.9	9.4 Jan
Italy	−2.9 Q4	−7.5	−3.7	+0.1	−20.7 Feb	+1.2 Mar	+3.3	+0.8	6.9 Q4
Netherlands	−0.6 Q4	−3.8	−2.7	+0.5	−12.7 Feb	+2.0 Mar	+2.2	+0.9	4.1 Mar††
Spain	−0.7 Q4	−3.8	−3.1	−0.5	−23.9 Feb	−0.1 Mar	+4.5	+0.3	15.5 Feb
Czech Republic	+0.7 Q4	−3.7	−3.0	+1.2	−23.4 Feb	+2.3 Mar	+7.1	+1.8	7.7 Mar
Denmark	−3.7 Q4	−7.3	−3.1	+0.5	−11.3 Feb†††	+1.8 Mar	+3.1	+1.1	2.5 Feb
Hungary	+2.0 Q4	−3.9	−3.0	+0.4	−25.4 Feb	+2.9 Mar	+6.7	+2.9	9.1 Feb††
Norway	+0.8 Q4	+5.6	−1.2	+0.5	−5.1 Feb	+2.5 Mar	+3.2	+1.7	3.1 Jan***
Poland	+2.9 Q4	na	+0.7	+2.2	−14.3 Feb	+3.6 Mar	+4.1	+3.0	10.9 Feb‡‡
Russia	+1.2 Q4	na	−3.0	+2.0	−13.7 Mar	+14.0 Mar	+13.3	+13.5	11.9 Mar‡‡
Sweden	−4.9 Q4	−9.3	−3.6	+0.7	−22.9 Feb	+0.2 Mar	+3.4	−0.1	8.3 Mar‡‡
Switzerland	−0.1 Q4	−1.2	−2.3	+0.1	−6.0 Q4	−0.4 Mar	+2.6	−0.2	3.3 Mar
Turkey	−6.2 Q4	na	−2.0	+1.5	−23.7 Feb	+7.9 Mar	+9.2	+7.8	12.3 Q4‡‡
Australia	+0.3 Q4	−2.1	−0.8	+1.6	−0.7 Q4	+2.5 Q1	+4.2	+2.1	5.7 Mar
Hong Kong	−2.5 Q4	−7.8	−5.9	−0.3	−10.3 Q4	+0.8 Feb	+6.3	+0.9	5.2 Mar††
India	+5.3 Q4	na	+5.0	+6.4	−1.2 Feb	+9.6 Feb	+5.5	+5.9	6.8 2008
Indonesia	+5.2 Q4	na	−1.3	+0.6	−2.4 Feb	+7.9 Mar	+6.3	+3.9	8.4 Aug
Malaysia	+0.1 Q4	na	−3.0	+1.1	−14.6 Feb	+3.5 Mar	+2.8	−0.7	3.0 Q4
Pakistan	+5.8 2008**	na	+1.2	+3.2	−8.9 Jan	+19.1 Mar	+14.1	+10.1	5.6 2007
Singapore	−11.5 Q1	−19.7	−7.5	+1.9	−22.4 Feb	+1.6 Mar	+6.7	+0.9	2.6 Q4
South Korea	−3.4 Q4	−20.8	−5.9	+0.3	−10.3 Feb	+3.9 Mar	+3.9	+0.1	3.7 Mar
Taiwan	−8.4 Q4	na	−6.5	+0.1	−27.1 Feb	−0.1 Mar	+3.9	−1.0	5.7 Mar
Thailand	−4.3 Q4	−22.2	−4.4	+1.4	−19.8 Feb	−0.2 Mar	+5.3	−1.2	2.4 Jan
Argentina	+4.9 Q4	−1.2	−2.8	+1.5	−14.0 Feb	+6.3 Mar	+8.8	+6.4	7.3 Q4‡‡
Brazil	+1.3 Q4	−13.6	−1.5	+2.7	−17.0 Feb	+5.6 Mar	+4.7	+4.4	8.5 Feb‡‡
Chile	+0.2 Q4	−8.3	−0.5	+2.4	−11.5 Feb	+5.0 Mar	+8.5	+3.0	8.5 Feb††‡‡
Colombia	−0.7 Q4	−4.1	−1.0	+1.5	−12.8 Feb	+6.1 Mar	+5.9	+5.0	12.5 Feb‡‡
Mexico	−1.6 Q4	−10.3	−4.4	+1.2	−13.2 Feb	+6.0 Mar	+4.3	+5.0	5.3 Feb‡‡
Venezuela	+3.2 Q4	na	−5.0	−5.4	−25.4 Dec	+28.6 Mar	+29.1	+30.1	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+3.8	+3.9	+7.3 Q3	+12.1 Mar	+14.4	+8.1	8.8 Q4‡‡
Israel	+1.2 Q4	−0.5	+0.4	+2.6	−4.1 Jan	+3.6 Mar	+3.7	+1.8	6.3 Q4
Saudi Arabia	+4.2 2008	na	+0.4	+3.3	na	+6.0 Mar	+8.3	+4.3	na
South Africa	+1.0 Q4	−1.8	−0.8	+3.1	+8.6 Feb	+8.6 Feb	+9.8	+6.0	21.9 Dec‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−9.7 Q4	na	−8.0	−1.5	−32.7 Feb	+2.0 Mar	+10.9	+1.0	8.6 Jan
Finland	−2.4 Q4	−5.0	−2.8	+0.5	−22.8 Feb	+0.9 Mar	+3.9	+0.7	7.1 Feb
Iceland	−1.3 Q4	−3.6	−12.4	−0.9	+0.4 2007	+15.2 Mar	+8.7	+12.5	8.9 Mar‡‡
Ireland	−7.5 Q4	−25.7	−4.8	−1.4	−0.8 Jan	−2.6 Mar	+5.0	−0.7	11.0 Mar
Latvia	−10.3 Q4	na	−15.0	−4.0	−24.2 Feb	+8.2 Mar	+16.7	+2.5	12.3 Jan
Lithuania	−2.2 Q4	−5.5	−8.5	−2.5	na	+7.6 Mar	+11.2	+4.3	9.5 Mar‡‡
Luxembourg	−0.3 Q3	−5.5	−2.9	−0.2	−24.1 Dec	+1.2 Feb	+3.1	+0.5	5.6 Feb‡‡
New Zealand	−2.3 Q4	−2.3	−3.2	+0.7	−0.5 Q3	+3.0 Q1	+3.4	+1.6	4.6 Q4
Peru	+3.2 Jan	na	+2.8	+3.9	−2.7 Jan	+4.8 Mar	+5.5	+4.7	9.4 Feb‡‡
Philippines	+4.5 Q4	+4.1	−1.9	+1.4	−19.9 Jan	+6.4 Mar	+6.4	+1.9	7.7 Q1‡‡
Portugal	−1.8 Q4	−6.2	−4.2	−0.5	−13.7 Feb	−0.4 Mar	+3.1	−1.0	7.8 Q4‡‡
Slovakia	+2.5 Q4	na	−2.0	+1.0	−27.4 Feb	+2.6 Mar	+4.2	+2.0	10.3 Mar‡‡
Slovenia	−0.8 Q4	na	−1.5	+1.0	−22.3 Feb	+1.8 Mar	+6.9	+1.5	8.2 Feb‡‡
Ukraine	+6.9 Q3	na	−6.0	+2.0	−30.4 Mar	+18.1 Mar	+26.2	+16.3	3.2 Feb
Vietnam	+5.5 Q4	na	+0.3	+1.1	+2.4 Mar	+11.2 Mar	+19.4	+4.3	4.6 2007

*% change on previous quarter, annual rate. †The Economist poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate -0.4 in Mar. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Apr 23rd 2009
From The Economist print edition

The Economist commodity-price index

2000=100

	Apr 14th	Apr 21st*	% change on one month	% change on one year
Dollar index				
All items	170.0	166.9	+3.3	-36.8
Food	191.5	189.6	+0.4	-28.1
Industrials				
All	142.1	137.7	+8.8	-48.0
Nfa†	121.9	118.2	+6.7	-38.3
Metals	153.2	148.3	+9.8	-51.3
Sterling index				
All items	173.0	173.1	+4.0	-13.8
Euro index				
All items	118.6	119.1	+7.8	-22.1
Gold				
$ per oz	888.65	882.15	-4.5	-4.0
West Texas Intermediate				
$ per barrel	49.47	46.95	-12.3	-60.6

*Provisional †Non-food agriculturals.

Poverty

Apr 23rd 2009
From The Economist print edition

Just over a quarter of the world population, or 1.4 billion people, lived in extreme poverty in 2005, according to the World Bank. That compares with 42% in 1990, when the bank first published its global poverty estimates. Rapid economic growth has led to a dramatic decline in poverty in China, where the share of people below the threshold of $1.25 a day fell from 60.2% to 15.9% between 1990 and 2005. But the poverty rate fell much more slowly in India, to 41.6% in 2005 from 51.3% in 1990. South Asia has the most very poor people of any region in the world. But the fraction of the population that lives in extreme poverty is highest, at 50.9%, in sub-Saharan Africa, though it has fallen there from 57.6% in 1990.

Trade, exchange rates, budget balances and interest rates

Apr 23rd 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Apr 22nd	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−761.0 Feb	−673.3 Q4	−3.3	–	–	−13.1	0.29	2.96
Japan	+21.0 Feb	+131.8 Feb	+1.5	98.1	104	−5.7	0.51	1.42
China	+316.9 Mar	+400.7 Q2	+6.2	6.83	6.98	−3.7	1.21	3.43
Britain	−163.1 Feb	−44.6 Q4	−1.7	0.69	0.50	−12.3	1.50	3.44
Canada	+37.1 Feb	+11.3 Q4	−2.0	1.24	1.02	−2.8	0.24	3.14
Euro area	−59.4 Feb	−90.2 Jan	−1.0	0.77	0.63	−5.3	1.41	3.21
Austria	−3.5 Jan	+16.8 Q3	+1.5	0.77	0.63	−4.6	1.41	4.02
Belgium	+8.2 Jan	−12.1 Dec	−1.4	0.77	0.63	−4.4	1.42	3.92
France	−79.9 Feb	−54.4 Feb	−2.2	0.77	0.63	−6.3	1.41	3.64
Germany	+234.6 Feb	+206.2 Feb	+4.5	0.77	0.63	−4.4	1.41	3.20
Greece	−63.2 Jan	−48.7 Feb	−12.6	0.77	0.63	−4.9	1.41	5.42
Italy	−15.7 Feb	−73.1 Jan	−2.6	0.77	0.63	−4.3	1.41	4.36
Netherlands	+50.2 Feb	+65.3 Q4	+5.9	0.77	0.63	−3.1	1.41	3.77
Spain	−131.7 Jan	−145.2 Jan	−7.5	0.77	0.63	−9.6	1.41	4.04
Czech Republic	+3.5 Feb	−7.2 Feb	−2.2	20.7	15.8	−3.6	2.52	5.50
Denmark	+6.7 Jan	+6.4 Feb	+1.0	5.72	4.70	−2.0	2.92	3.71
Hungary	−0.2 Feb	−13.0 Q4	−3.7	228	158	−2.7	9.69	10.80
Norway	+70.5 Mar	+83.4 Q4	+10.5	6.71	5.01	10.5	2.81	3.97
Poland	−22.2 Feb	−25.5 Feb	−5.1	3.39	2.15	−3.2	4.24	6.01
Russia	+159.3 Feb	+98.9 Q4	−2.2	33.9	23.4	−8.0	13.00	10.93
Sweden	+14.3 Feb	+40.3 Q4	+7.3	8.42	5.88	−4.7	0.20	3.15
Switzerland	+16.9 Mar	+53.3 Q4	+7.5	1.16	1.02	−2.0	0.40	2.03
Turkey	−60.8 Feb	−33.1 Feb	−1.3	1.64	1.29	−4.4	10.91	7.69‡
Australia	+2.2 Feb	−44.1 Q4	−5.2	1.41	1.05	−3.1	3.07	4.46
Hong Kong	−25.1 Feb	+30.6 Q4	+8.1	7.75	7.79	−4.0	0.90	2.06
India	−113.3 Feb	−37.5 Q4	−3.4	50.3	40.1	−7.3	3.80	7.45
Indonesia	+7.2 Feb	+0.6 Q4	−0.4	10,855	9,210	−2.9	8.81	8.93‡
Malaysia	+42.1 Feb	+39.1 Q4	+10.2	3.64	3.13	−8.7	2.09	3.44‡
Pakistan	−18.7 Mar	−15.3 Q4	−1.3	80.6	64.6	−6.4	13.14	18.34‡
Singapore	+16.3 Mar	+27.1 Q4	+17.2	1.51	1.35	−4.1	0.58	1.95
South Korea	−2.8 Mar	+0.7 Feb	+1.9	1,348	991	−6.5	2.41	4.76
Taiwan	+9.8 Mar	+25.0 Q4	+7.9	33.9	30.3	−5.0	0.85	1.49
Thailand	+6.1 Feb	+4.5 Feb	+2.0	35.6	31.5	−4.7	1.50	2.53
Argentina	+13.1 Feb	+7.6 Q4	−0.5	3.70	3.18	−0.8	14.44	na
Brazil	+25.0 Mar	−25.7 Feb	−2.0	2.22	1.66	−1.9	11.16	6.16‡
Chile	+4.6 Mar	−3.4 Q4	−3.8	584	445	−3.4	2.40	3.50‡
Colombia	+2.1 Feb	−6.8 Q4	−4.0	2,320	1,764	−3.3	7.15	6.43‡
Mexico	−16.0 Feb	−2.4 Q4	−3.5	13.2	10.5	−5.3	5.84	7.53
Venezuela	+39.2 Q4	+39.2 Q4	+0.1	6.60	3.33§	−5.3	16.03	6.55‡
Egypt	−26.8 Q4	−1.3 Q4	−0.5	5.64	5.37	−7.0	10.47	3.10‡
Israel	−12.0 Mar	+1.6 Q4	+1.9	4.24	3.44	−5.0	0.39	3.39
Saudi Arabia	+197.4 2008	+124.0 2008	−8.0	3.75	3.75	−8.7	0.95	na
South Africa	−8.0 Feb	−21.0 Q4	−7.0	8.90	7.65	−3.3	8.60	8.31
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−3.2 Feb	−1.8 Feb	−3.0	12.0	9.85	−3.5	6.45	na
Finland	+8.8 Jan	+3.4 Feb	+2.4	0.77	0.63	−4.1	1.40	3.83
Iceland	+0.2 Mar	−5.6 Q4	+0.5	131	73.7	−9.5	13.88	na
Ireland	+44.3 Jan	−12.7 Q4	−2.5	0.77	0.63	−12.0	1.41	5.30
Latvia	−5.2 Feb	−4.0 Jan	−4.0	0.55	0.44	−6.0	10.64	na
Lithuania	−6.1 Feb	−5.1 Feb	−4.0	2.65	2.17	−2.7	6.83	na
Luxembourg	−7.8 Jan	+3.0 Q4	na	0.77	0.63	−3.9	1.41	na
New Zealand	−3.5 Feb	−11.3 Q4	−6.7	1.80	1.25	−6.3	4.05	5.10
Peru	+2.2 Feb	−4.2 Q4	−5.9	3.08	2.79	−1.8	5.05	na
Philippines	−7.6 Jan	+4.2 Dec	+2.0	48.7	41.9	−2.7	4.38	na
Portugal	−33.8 Jan	−29.0 Jan	−9.7	0.77	0.63	−4.9	1.41	4.52
Slovakia	−1.2 Feb	−7.0 Jan	−6.2	23.1	20.4	−4.0	1.35	4.40
Slovenia	−4.3 Feb	−2.6 Jan	−3.5	0.77	0.63	−3.7	1.41	na
Ukraine	−16.9 Q4	−12.9 Q4	−3.8	8.07	4.92	−1.0	17.70	na
Vietnam	−12.2 Feb	−7.0 2007	−1.8	17,783	16,115	−8.2	8.03	7.99

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Apr 23rd 2009
From The Economist print edition

Markets

	Index Apr 22nd	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	7,886.6	−1.8	−10.1	−10.1
United States (S&P 500)	843.6	−1.0	−6.6	−6.6
United States (NAScomp)	1,646.1	+1.2	+4.4	+4.4
Japan (Nikkei 225)	8,727.3	−0.2	−1.5	−10.2
Japan (Topix)	830.0	−0.6	−3.4	−11.9
China (SSEA)	2,583.6	−2.9	+35.1	+35.0
China (SSEB, $ terms)	161.6	−3.6	+45.9	+45.7
Britain (FTSE 100)	4,030.7	+1.6	−9.1	−5.3
Canada (S&P TSX)	9,279.2	+0.4	+3.2	+5.5
Euro area (FTSE Euro 100)	705.7	+1.3	−5.4	−10.4
Euro area (DJ STOXX 50)	2,285.7	+1.0	−6.6	−11.5
Austria (ATX)	1,807.3	−2.4	+3.2	−2.1
Belgium (Bel 20)	1,903.9	+3.0	−0.2	−5.4
France (CAC 40)	3,025.2	+1.3	−6.0	−10.9
Germany (DAX)*	4,594.4	+1.0	−4.5	−9.5
Greece (Athex Comp)	1,894.6	−1.7	+6.0	+0.5
Italy (S&P/MIB)	18,086.0	+1.5	−7.1	−11.9
Netherlands (AEX)	236.9	+0.4	−3.7	−8.7
Spain (Madrid SE)	923.6	+0.9	−5.4	−10.3
Czech Republic (PX)	822.3	−2.1	−4.2	−9.1
Denmark (OMXCB)	239.4	+8.1	+5.8	+0.3
Hungary (BUX)	12,467.1	+2.1	+1.8	−11.7
Norway (OSEAX)	283.0	+2.7	+4.7	+8.9
Poland (WIG)	27,431.0	−3.0	+0.7	−7.7
Russia (RTS, $ terms)	785.1	−2.6	+36.2	+24.3
Sweden (OMXS30)†	768.1	+5.3	+16.0	+10.6
Switzerland (SMI)	5,063.7	nil	−8.5	−15.1
Turkey (ISE)	28,956.8	+2.2	+7.8	+3.7
Australia (All Ord.)	3,627.2	−1.8	−0.9	+1.4
Hong Kong (Hang Seng)	14,878.5	−5.0	+3.4	+3.4
India (BSE)	10,817.5	−4.1	+12.1	+10.0
Indonesia (JSX)	1,615.2	+1.4	+19.2	+19.2
Malaysia (KLSE)	968.6	+1.2	+10.5	+6.0
Pakistan (KSE)	7,574.2	−3.0	+29.1	+26.9
Singapore (STI)	1,843.4	−3.3	+4.6	+0.3
South Korea (KOSPI)	1,356.0	+1.7	+20.6	+13.5
Taiwan (TWI)	5,886.1	+0.2	+28.2	+24.5
Thailand (SET)	460.6	+1.5	+2.4	+0.5
Argentina (MERV)	1,227.0	+1.0	+13.6	+6.8
Brazil (BVSP)	44,888.0	−0.8	+19.5	+26.6
Chile (IGPA)	12,751.4	+1.6	+12.6	+23.8
Colombia (IGBC)	8,044.9	−1.1	+6.4	+0.4
Mexico (IPC)	21,480.0	−1.7	−4.0	+0.8
Venezuela (IBC)	44,485.5	+1.2	+26.8	+36.5
Egypt (Case 30)	4,980.4	+3.7	+8.4	+6.0
Israel (TA-100)	700.2	−2.3	+24.1	+12.3
Saudi Arabia (Tadawul)	5,216.8	−3.0	+8.6	+8.7
South Africa (JSE AS)	19,798.4	−7.1	−8.0	−7.2
Europe (FTSEurofirst 300)	795.2	+0.9	−4.4	−9.4
World, dev'd (MSCI)	857.5	−0.7	−6.8	−6.8
Emerging markets (MSCI)	629.2	−2.3	+11.0	+11.0
World, all (MSCI)	216.0	−0.9	−5.1	−5.1
World bonds (Citigroup)	763.2	−0.6	−5.8	−5.8
EMBI+ (JPMorgan)	417.4	−0.6	+6.6	+6.6
Hedge funds (HFRX)§	1,038.0	+0.3	+1.7	+1.7
Volatility, US (VIX)	38.1	36.2	40.0	(levels)
CDSs, Eur (iTRAXX)‡	179.3	+0.8	−11.3	−15.9
CDSs, N Am (CDX)‡	249.2	+5.8	+6.8	+6.8
Carbon trading (EU ETS) €	13.6	−2.2	−15.8	−20.2

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Apr 21st

Exchange rates against the dollar

Apr 23rd 2009
From The Economist print edition

Most major currencies have weakened against the dollar since the end of last year. Comparing currencies on April 22nd, the biggest loser has been the Swiss franc, which has fallen by 8.4% this year. This was in part because of the intervention of the Swiss central bank in currency markets on March 12th to push the franc's value down. But the euro, the Korean won and the Swedish krona have also weakened by more than 6% against the dollar, and the yen has fallen by 7.6%. The Australian dollar, the Canadian dollar and Chinese yuan were almost steady. This year has been kinder to the pound than to other major currencies: it has risen by 1.1% against the dollar—but only after collapsing in 2008.